National Economic Policy

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THE PRESIDENTIAL REPORTS

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by

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To Natalie and Sarah, James, and Diane

PREFACE

ECONOMISTS HAVE LONG complained that national governments seldom pay much attention to their recommendations for national economic policy. Then in 1946 the Congress of the United States passed the Employment Act. Volumes of testimony by economists from all schools of thinking, giving prescriptions on how the objectives of this measure can best be attained, have since been recorded. This Act not only placed the Federal government in the business of planning for full employment, but it also created the Council of Economic Advisers, the Joint Economic Committee, and the President's Annual Economic Report.

The purpose of this book is to examine these Reports (after a survey of the Employment Act), beginning with the first one for 1947, and to depict their influence on the formulation of national economic policy since then. We will consider both the Reports of the President and the supporting materials which constitute the Council's Report to the President.

To show the development of the various types of economic policies in the Presidential and Council Economic Reports our procedure has been as follows. For Reports between 1947 and 1959, we have summarized, in the main, the salient features of policy formulations. Beginning with the 1960 Report, however, our approach has been to cite the policy area and then to present excerpts from the Reports so that the reader can read the actual language and follow the development of the various policies and recommendations over a period of time. We have abstracted little from the earlier Reports for two reasons: much of the material now is basically of historical import; and many of these earlier ideas have been incorporated in the later Reports.

In general, for the Reports prior to 1960, excerpts from the President's summary of the preceding year are given. From several Reports we have abstracted the policy recommendations. Where the Reports present analytical and philosophical studies we present samples of these.

Ever since the publication of the Presidential Economic Reports teachers of economics have been supplied with this excellent series of documents that has proved most valuable in their varied courses.

As the number of Reports has increased since the first one, however, it has become increasingly difficult and cumbersome to review all of these in a given class. This volume aims to help both the instructor and the student in following the Economic Reports over the years, by reviewing the major issues discussed in them.

The author wishes to thank Dr. Mark Perlman, Chairman and Professor of the Department of Economics, University of Pittsburgh, for his guidance and inspiration; and the editorial staff of D. Van Nostrand for their excellent assistance throughout the preparation of this volume.

REUBEN E. SLESINGER

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INTRODUCTION

THE REPORTS FROM 1947 on have undergone change in both format and content. For the years 1947–1952, two reports were submitted: one in January and one in July. The latter, the mid-year Report, essentially was an updating of the January one. It is interesting to note that the subjects selected for treatment in the first Report (1947)—the review of the preceding year, prices, wages, profits, employment, production, stabilization, budgetary and fiscal policy, credit and monetary policy, and international economies—have continued, in the main, to constitute the heart of the succeeding Reports, although with changes in emphasis. As the years moved on, more elaborate statistical information has been included as a significant feature. Beginning with the 1949 Report, the President started the document with his own report which became a rather lengthy review of the nation's economic health. This was followed by a detailed report of several chapters by the Council of Economic Advisers. The Council's Report became essentially an analytical and statistical support for the President's more general review. In effect, the President's Report gave the summary and the framework and the Council's Report filled in the details.

In some instances, valuable appendices presenting detailed discussions of special problem areas have been included in the Reports. Some of the earlier Reports also included a helpful section that summarized both the important legislative recommendations and the significant economic administrative and legislative actions of the preceding year.

Considered as a total document, the Reports may be classified as being concerned primarily with macro-economics. In general, those of President Truman leaned toward a greater reliance on the role of government than did those of his successor, Eisenhower. The Reports of President Eisenhower (1954–1961) differed in format. Instead of the division into the President's and the Council's Reports, the document was submitted to Congress as the Report of the President accompanied by a few-page letter of transmittal. The chapters that followed, however, differed little from the prior Council Reports. A greater emphasis was placed on the need for recognizing and strengthening the institutions of free-enterprise in American society.

The Reports from 1962 on returned to the earlier format and were divided into a section containing the President's Report and the Annual Report of the Council of Economic Advisers. Also, in the more recent ones, one can see the shift to more reliance on an increasing role for government in promoting and sustaining economic growth.

The typical Report outlines a series of proposals for economic legislation, reflecting the current economic problems. The Council Report gives background detail for the President's recommendations. The Council Reports become significant examinations of the status of current Federal government policy on economic affairs. In many instances, Federal policy has evolved throughout the years, appearing in one Report as a suggestion and then re-appearing later as a positive program.

In the presentation that follows, we will select a series of basic economic problems and policies and trace how these have been approached through comments and suggestions in the various Reports. In this manner, it is possible also to trace the influence of these Reports on the making of national economic policy in the United States.

In spanning the report years from 1947 to 1967, we note that the heart of the 1967 Report is not much different from that of its predecessors so far as topics of coverage are concerned. It examines the significant economic events of the past year; reviews problems of fiscal policy, monetary policy, prices, and stabilization; describes economic policy in general; presents international economic policies; and examines the intricacies of growth. This last Report delves further than its predecessors, however, into policies to aid the disadvantaged, and also reflects the economic impact of the activities in Vietnam.

PART ONE

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The Employment Act of 1946: The Measure and Its Background

SERIOUS CONCERN OVER unemployment attendant to demobilization after World War II was expressed long before 1946. In fact, the war was under way only for a short while when the National Resources Planning Board in 1942 expressed the thought that a program of full employment and expansion would be necessary after the war, and that such a program had to be pursued with vigor. The Board declared that it was the responsibility of the Federal government to promote high levels of production and consumption, and to assure full employment.

The idea that a national government should underwrite full employment, although somewhat novel in the United States, was not unknown. Aside from the Keynesian prescription that called for governmental contracyclical spending during recessionary periods, the British had the proposal by Sir William Beveridge that the national government should provide a national employment budget (supported by national expenditures) that would supplement private investment and expenditure so as to provide for full employment. (See Beveridge, *Full Employment in a Free Society*.)

Although the National Resources Planning Board was dissolved in 1943, its emphasis on full employment did focus attention on this problem. Early in 1944, President Roosevelt declared that everybody had a right to a job. Belief in this right to a remunerative job was nonpartisan. Republicans as well as Democrats expressed views that each American was entitled to a job, and in varying ways indicated that the Federal government had a responsibility to provide such a job if the private sector did not create sufficient employment opportunities.

As it became evident that Allied victory in World War II was near, anxiety over the effects of post-war unemployment increased. The fear was accentuated by the picture of the demobilization, within a short

mention the President's responsibility to guard against inflation, deflation, and monopolistic practices as these might interfere with reaching full employment. It may be assumed, from the nature of the debate, however, that no intent existed to reduce unemployment to zero, but rather to a minimum (perhaps accepting voluntary unemployment) consistent with the idea of full employment.

As the debate ensued, several amendments were suggested. A significant one changed the idea of the Federal government's total responsibility for full employment to that of engaging in public works programs only to the extent consistent with the government's total program of needs and obligations, rather than as a balancing force. Some opponents argued that the measure would call for permanent government deficits, and thus called for accompanying tax cuts. Others expressed a fear lest the governmental programs might actually hurt the private economy, and thereby reduce the volume of employment in that sector.

Meanwhile, economic conditions in 1945 improved. A number of factors merged to bring about not recession, but expansion and some inflation. Differences of opinion appeared between leading Senate and House members over the merits of the "full employment concept." Pressure mounted to dilute the possible governmental responsibility for full employment as well as to delete references to the right to work. Instead of "full employment" it was suggested that the measure focus on a "high level" of employment. The idea of an annual economic report was suggested instead of the President's economic budget. A council of economic advisers, as well as a joint economic committee, also was suggested.

President Truman was not generally in favor of these compromises, and in his report to Congress early in 1946 he reiterated his desire for a "full" employment measure.

Finally on 20 February 1946, President Truman signed into law the Employment Act of 1946. This measure represented a far departure from the original Murray full employment bill, and nowhere did it mention the phrase "full employment."

rent and foreseeable trends in the levels of employment, production, and purchasing power; (3) a review of the economic program of the Federal Government and a review of economic conditions affecting employment in the United States or any considerable portion thereof during the preceding year and of their effect upon employment, production, and purchasing power; and (4) a program for carrying out the policy declared in section 2, together with such recommendations for legislation as he may deem necessary or desirable.

(b) The President may transmit from time to time to the Congress reports supplementary to the Economic Report, each of which shall include such supplementary or revised recommendations as he may deem necessary or desirable to achieve the policy declared in section 2.

(c) The Economic Report, and all supplementary reports transmitted under subsection (b) of this section, shall, when transmitted to Congress, be referred to the joint committee created by section 5. . . .

COUNCIL OF ECONOMIC ADVISERS TO THE PRESIDENT

SEC. 4. (a) There is hereby created in the Executive Office of the President a Council of Economic Advisers (hereinafter called the "Council"). The Council shall be composed of three members who shall be appointed by the President, by and with the advice and consent of the Senate, and each of whom shall be a person who, as a result of his training, experience, and attainments is exceptionally qualified to analyze and interpret economic developments, to appraise programs and activities of the Government in the light of the policy declared in section 2, and to formulate and recommend national economic policy to promote employment, production, and purchasing power under free competitive enterprise. The President shall designate one of the members of the Council as Chairman.

(b) The Council is authorized to employ, and fix the compensation of, such specialists and other experts as may be necessary for the carrying out of its functions under this Act, without regard to the civil service laws and the Classification Act of 1949, as amended, and is authorized, subject to the civil service laws, to employ such other officers and employees as may be necessary for carrying out its functions under this Act, and fix their compensation in accordance with the Classification Act of 1949, as amended.

(c) It shall be the duty and function of the Council—

(1) to assist and advise the President in the preparation of the Economic Report;

(2) to gather timely and authoritative information concerning economic developments and economic trends, both current and prospective, to analyze and interpret such information in the light of the policy declared in section 2 for the purpose of determining whether such developments and trends are interfering, or are likely to interfere, with the achievement of such policy, and to compile

and submit to the President studies relating to such developments and trends;

(3) to appraise the various programs and activities of the Federal Government in the light of the policy declared in section 2 for the purpose of determining the extent to which such programs and activities are contributing, and the extent to which they are not contributing, to the achievement of such policy and to make recommendations to the President with respect thereto;

(4) to develop and recommend to the President national economic policies to foster and promote free competitive enterprise, to avoid economic fluctuations or to diminish the effects thereof, and to maintain employment, production, and purchasing power;

(5) to make and furnish such studies, reports thereon, and recommendations with respect to matters of Federal economic policy and legislation as the President may request.

(d) The Council shall make an annual report to the President in December of each year.

(e) In exercising its powers, functions, and duties under this Act—

(1) the Council may constitute such advisory committees and may consult with such representatives of industry, agriculture, labor, consumers, State and local governments, and other groups as it deems advisable;

(2) the Council shall, to the fullest extent possible, utilize the services, facilities, and information (including statistical information) of other Government agencies as well as of private research agencies, in order that duplication of effort and expense may be avoided.

(f) To enable the Council to exercise its powers, functions, and duties under this Act, there are authorized to be appropriated such sums as may be necessary. . . .

JOINT ECONOMIC COMMITTEE

SEC. 5. (a) There is hereby established a Joint Economic Committee, to be composed of eight Members of the Senate, to be appointed by the President of the Senate, and eight Members of the House of Representatives, to be appointed by the Speaker of the House of Representatives. In each case, the majority party shall be represented by five members and the minority party shall be represented by three members.

(b) It shall be the function of the joint committee—

(1) to make a continuing study of matters relating to the Economic Report;

(2) to study means of coordinating programs in order to further the policy of this Act; and

(3) as a guide to the several committees of the Congress dealing with legislation relating to the Economic Report, not later than March 1, of each year (beginning with the year 1947) to file a report with the Senate and the House of Representatives containing its

> findings and recommendations with respect to each of the main recommendations made by the President in the Economic Report, and from time to time to make such other reports and recommendations to the Senate and House of Representatives as it deems advisable. . . .

It is apparent in reviewing the Act that it carefully avoided reference to the phrase "full employment," but instead spoke of a maximization of employment, production, and purchasing power. This gave rise to an endless debate about the trade-off between increased employment and inflation, on the one hand, and lesser employment and price stability, on the other. Much of the phraseology is somewhat vague and normative in its expression. There is an endorsement of the free enterprise system, and mention that the activities of the Federal government are to be within the bounds of such an economic organization. The Federal government is not compelled to present an economic employment budget. Instead, the policy is declared to be one that, consistent with needs, obligations, and national considerations, will foster a climate in which the triumvirate of objectives (employment, purchasing power, and production) will be obtained.

It is little wonder, then, that the advocates of the original Murray Bill were quite disappointed, arguing that the measure not only was vague but provided no guarantees for anybody.

PART TWO

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The Early Economic Reports

In Part II, we present sample highlights from the reports submitted by President Truman and the ones transmitted by President Eisenhower (through 1959). Since much of the material in these earlier reports is historical now and is of interest to us more by way of understanding the past than of influencing current policy, we have culled them to give the reader a sample of the types of problems discussed, rather than a breakdown according to the policies themselves. This latter type of approach remains to be used for the reports issued from 1960 onward.

1. Prices and wages

Removal of emergency price and wage controls has restored the main responsibility for prices and wages to business, labor, farmers, and consumers. The Government can point out dangers seen from the perspective of the whole economy, but the correctives must largely be applied by others.

Business should reduce prices wherever possible in order to bring about the necessary increase in consumer purchasing power to bolster their markets. Price reductions are especially needed in the case of goods such as many articles of food, clothing, housefurnishings, and building materials, whose prices have risen out of line. If business makes these reductions in a timely and orderly way, it will help sustain markets rather than destroy them.

Farmers must realize that last year's exceptional farm prices will fall somewhat as world food supplies increase and as consumers find a more ample supply of durable goods to purchase. Existing price supports afford protection against a severe price decline.

Labor, on its part, must recognize that high volume at low costs and low prices requires high productivity and the absence of restrictions on production. For its own advantage as well as that of the country at large, labor should refrain from demands for excessive wage increases that would require price increases or would prevent price reductions that are necessary to sell the capacity output of the product.

Management in turn should recognize that increased productivity permits wage increases in some cases as well as price reductions; and that wages and salaries need to be raised where they have lagged substantially behind the increase in living costs in the past few years or where they are substandard.

But just as there can be no universal or uniform rule to govern price reductions, so there can be no uniform rule relating to wages. Both price adjustments and wage adjustments are necessary in the ensuing months. Wage adjustments, like price adjustments, need to be made with a discriminating regard for individual situations throughout the economy.

The Government can help in several ways to maintain a balance between prices and wages. Procurement agencies will avoid policies that stimulate price increases or prevent reductions. Disposal of surplus goods will be speeded. The antitrust laws will be applied vigorously to prevent and eliminate restrictive practices and pricing abuses.

The Congress should take steps at once to extend rent control beyond next June. A large increase in rents would substantially reduce consumer purchasing power.

On the wage side, the Congress should extend the coverage of the Fair Labor Standards Act to classes of workers in interstate commerce now excluded, and should raise the minimum wage in view of the substantial

rise in the cost of living and in the national production since it was enacted. . . .

LONG-RANGE PROGRAM

The war has left us a tremendously increased productive potential, and further increases are in store. In order to keep our expanding economic activity in line with our growing capacities, the extraordinary postwar demand that we enjoy today must be transformed into sustained demand of an expanding peacetime economy.

Elimination of wartime controls does not mean that we want to go back to the size of economy we had before the war. The possibilities and requirements of a sustained 200-billion-dollar economy differ from those of an unstable 100-billion-dollar economy.

A variety of measures will be needed to fortify the basic structure of the American economy before the transformation from war and reconversion to a high-consumption peacetime economy is completed. We are still at the threshold in formulating a program of consistent policies designed to give business, agriculture, and labor the opportunities which are envisaged in Employment Act.

A long-range program designed to strengthen the structure of the American economy should include policies toward:

1. Efficient utilization of the labor force;
2. Maximum utilization of productive resources;
3. Encouragement of free competitive enterprise;
4. Promoting welfare, health and security;
5. Cooperation in international economic relations;
6. Combating economic fluctuations.

The mid-year Report for 1947 covered much the same ground as did the basic Report, and served primarily to up-date data and economic behavior.

President Truman's Economic Report of 1948

The 1948 Economic Report was more than double the size of its predecessor, and introduced a format that set the style for many of the more recent Reports. We excerpt some of the materials from the foreword, summary, and statement of objectives (pp. 1–6).

PRICES, WAGES, PROFITS, AND INFLATION IN 1947

At the time of the first Economic Report a year ago, I warned against the danger of advancing prices, which would undermine our structure of national prosperity. I strongly urged businessmen to bring prices into line with the requirements of a stabilized economy. I called upon workers to limit their demands for wage increases to those situations where wages

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were substandard or where wage increases would not necessitate higher prices. I called for the holding of public works down to the minimum of necessity and called upon procurement agencies to avoid practices that would stimulate price increases. . . .

The record of prices, wages and profits during 1947 shows how they fed upon one another in a developing process of inflation. In spite of the heartening production record of the year, this inflationary trend was profoundly disturbing. It not only produced great inequities among our people, but also created the danger of a serious setback.

The purposes of the Employment Act are beginning to meet their first real test. Unless we as a nation show an ability to impose restraints upon ourselves and to utilize the machinery of our representative government to devise well-considered regulatory measures, we stand in great danger that runaway prices, overextended credit, and unbalanced developments will lead to an economic recession. We cannot be sure that such a recession would not be severe and recovery slow and painful.

OBJECTIVES FOR 1948

The first objective for 1948 must be to halt the inflationary trend. On November 17, I recommended to the Congress a ten-point program for this purpose. Every point in that program is essential.

The nature of the inflation from which we are suffering arises in part from the total excess of buying power over the available supply of goods and in part from relative scarcities at strategic points in the economy which give impetus to particular price-wage spirals.

To deal with these two phases of inflation, my ten-point program divides into three main parts. First, it proposes appropriate restraints upon business credit and consumer credit and commodity speculation. Second, to deal with the scarcities at strategic spots in the economy, it calls for authority to allocate to their most efficient and necessary uses those scarce commodities and services which enter basically into the cost of living or industrial production. And third, it calls for the extension and strengthening of rent control, and for authority to impose rationing and price control on a highly selective basis on items of outstanding importance to industrial production or to the cost of living so that these powers may be used promptly to protect the public if other measures prove inadequate.

As I have made clear in a statement on December 29, the three points in my ten-point program which were enacted in the special session of the Congress are necessary but insufficient. The other seven points are needed, needed badly, and needed promptly.

This program, which the situation requires, does not lessen the need for voluntary restraint. This applies both to those who price goods and those who buy goods. No program undertaken by the Government can succeed unless it is accompanied by public cooperation based upon a realization of common dangers and common objectives.

Taxes at present are providing revenues substantially larger than expenditures. It is important to maintain this favorable balance as long as the inflationary trend continues. However, certain adjustments need to be made immediately in order to protect those in the lower income groups hit hardest by inflation.

Our second main objective for 1948 should be to maintain maximum employment, achieve maximum production, and adjust the price-income structure so as to stop the inflationary spiral without production cutbacks or extensive unemployment.

More production this year will help in combatting inflation, but there is no possibility of enough additional production this year to overcome inflation without other measures. In fact, if these other measures are not undertaken, inflation may cause such disruption of our economy as to drive production and employment downward.

With healthy adjustments in our economy achieved during the year, our employment objective should be to absorb in useful work the net increase of 700,000 additional people in the labor force. This would mean an average of nearly 59 million jobs for the year as a whole, contrasted with about 58 million as the year's average for 1947.

Our objective for production should be to increase the total output of goods and services by some 3 percent above 1947.

Our third main objective for 1948 should be to establish firmer foundations for the long-range growth and prosperity of our economy in the years ahead. . . .

In subsequent chapters, the Report discussed long-range objectives for a high-production economy. Hope was expressed that industrial wage-price-profit policies would be equitable and would be achieved without compulsion. Emphasis was placed on the fact that a larger flow of income to consumers is necessary for the balanced expansion of the economy.

The levels of economic activity were described in detail and concern was expressed over the upward trend of prices. Inflationary forces at that time were associated mainly with excesses in demand. A clear statement of why inflation is dangerous followed, and we now present that statement (pp. 43–44).

WHY INFLATION IS DANGEROUS

During the course of an inflationary movement there are many who find it difficult to think that anything is wrong. There is a ready market, everyone is employed, wages are good, production is high, profits are good, and industrial capacity is being expanded.

There are some, indeed, who find real merit in the situation. They say that the cure for specific shortages is still higher prices. They expect that these will stimulate larger output and restore balance. But this is

a vain hope. The stubborn and intractable fact about an economy already operating at peak levels is that output cannot be expanded except by slow degrees.

Nor are the immediate consequences of inflation as favorable as superficially appears. Some people are gaining at the expense of others. The heavy weight of higher costs of living bears down upon the millions of families who are unable to keep up with the advancing prices. Economic relations degenerate into a hectic struggle to catch up or keep ahead. No firm basis can be established for orderly and stable progress.

But what most fully justifies every effort to halt an inflation is the certainty that, if it runs its course unimpeded, it will spread in its wake the disaster of falling markets, unemployment, and business losses. A rapid general rise in prices has the effect of unduly bunching investment in inventories and equipment at early dates and according to distorted calculations of possible profit. It induces investments, many of which will not pay out.

Rising prices breed upon easy access to credit, which supports the trend. They introduce speculative activities which also support the trend. They produce a price structure which is increasingly sensitive and precarious and vulnerable to changes in business and consumer expectations, spending, and investment.

At whatever point these developments induce a reversal of business sentiment or a withholding of consumer demand, some markets weaken, with a spreading impact. Caution dictates the withholding of demand. Buying for inventory, capital expansion, and consumption declines. A decline of production necessarily follows, spreading unemployment and loss of income from point to point in a widening and deepening downward spiral.

These developments are not inescapable. A well-designed program of measures to combat the inflationary trend will permit us to reach a state of economic stability without an interlude of severe depression. . . .

The 1949 Report introduced the idea of a separation between the resident's Report *per se* and the annual review and Report of his ouncil of Economic Advisers. The Report began with a description ꞉ the sources of our economic strength. A series of legislative recomıendations then followed, colored primarily by fears of inflation. 'hus, the Report argued that it was ". . . essential to sound fiscal olicy to have a budget surplus now." Various types of controls were ılled for such as over credit, rent, and exports.

By 1949, the Council's review of economic conditions took on the ›rm that it has used in recent years and furnished the analytical and atistical support for the President's review and summary. The Coun- l discussed the course of employment and production, prices, wages, ıd profits. It further analyzed the proposed national goals and indi-

cated the need for action in connection with fiscal and monetary policies, critical shortages, rents, and prices. The ingredients of balanced economic growth received special attention, especially from the point of view of the requirements for promoting a stable economy.

The mid-year report followed in a similar vein, and with more current data. It contained a summary of recommendations for economic legislation.

President Truman's Economic Report of 1950

The 1950 Report was the last one prior to the Korean War. After reviewing the economic situation, the Report presented the basis for a unified national economic policy, as depicted below (pp. 6–8).

> . . . These facts show our tremendous economic strength. But this strength does not rest in material things alone.
>
> If we are to continue our economic growth the major economic groups must all pull together—businessmen, wage earners, and farmers must work toward the same ends. Government, in turn, must carry out the aspirations of the whole people.
>
> Our success will depend upon the widespread conviction that all groups have a stake in the expansion of the economy—that all will share in the benefits of progress. In the days ahead we must broaden our understanding of how the various interests of our people are interrelated.
>
> Toward this end, I should like to point out certain principles on which we can all base our economic efforts. The more widely these principles are understood, the better able we shall be to solve our common problems and reconcile the interests of different economic groups. The more widely these principles are used as the basis for economic action and decision, the more rapid will be our national progress.
>
> *First.* Our economy can and must continue to grow.
>
> An expanding population and an increasingly productive labor force require constantly expanding employment opportunities and steadily rising levels of investment and consumption. Within five years, we can achieve an annual output in excess of 300 billion dollars. The gain in national income would be equal to an average of nearly $1,000 for every family in the United States. This would greatly improve standards of living. It would go far toward our goal of the complete elimination of poverty. It would provide employment opportunities for about 64 million workers.
>
> Such prospects are not fanciful. They are based upon our long-term record of achievement, including some years when we did not use fully our resources of plant, managerial skills, and labor force. And today, we are better equipped with these resources than ever before.
>
> But we will not make this progress within five years unless we begin to move in that direction now. Our immediate goal for 1950 should be

to regain maximum employment. This requires the reduction of unemployment to the minimum level consistent with labor mobility in a free economy. We should strive this year to reduce unemployment from 3½ to 2 million, or 2½ million at most. This would mean about 61 million civilian jobs. It would mean stepping up our national output by about 7 percent above the 1949 total. These are our objectives for this year under the Employment Act. If we put forth sufficient effort, we can reach these objectives before the year's end.

Second. The benefits of growth and progress must extend to all groups.

Only in this way can the long-run welfare of any group be preserved. If any part of our economy is depressed, or fails to gain, it can only serve as a drag against the gains of other parts. There is no room for the feeling that one group can prosper only at the expense of another. There is abundant opportunity for all groups to prosper together. Expansion to a 300 billion dollar economy within five years would place 30 to 45 billion dollars more per year in the hands of consumers for buying the needs and comforts of life. It would provide opportunity for profitable business investment in plant, equipment, and housing which might run 3 to 6 billion dollars per year above the 1949 level. It would enable farmers to sell about 10 per cent more food for domestic consumption.

Third. This growth will not come automatically, but requires conscious purpose and hard work.

Productivity per worker should be increased by at least 2 to 2½ percent a year. Labor should base its policies on the prospect of a stable and expanding economy. Businessmen should base their investment policies on confidence in growth, shape their price policies to the needs of larger markets, and proceed with vigor and ingenuity to develop new and better products of all kinds. Farmers should make full use of new technology, and make shifts in production toward those commodities most needed in a growing peacetime economy.

To promote an environment in which businessmen, labor, and farmers can act most effectively to achieve steady economic growth is a major task of the Government. It must perfect measures for helping to stabilize the economy. It must build up the natural resources which are essential to economic progress, and expand the protective measures against human insecurity. It must keep open the channels of competition, promote free collective bargaining, and encourage expanded opportunities for private initiative.

Fourth. The fiscal policy of the Federal Government must be designed to contribute to the growth of the economy. . . .

The Federal Budget is an important part of the national economy. Wise budgetary policies can promote stability and maximum production and employment throughout the economy.

In fields such as resource development, education, health, and social security, Government programs are essential elements of our economic strength. If we cut these programs below the requirements of an expanding economy, we should be weakening some of the most important factors

which promote that expansion. Furthermore, we must maintain our programs for national security and international peace. These programs are the defense of the world against disatser. Upon them, our whole future depends.

Government revenue policy should take into account both the needs of sound Government finance and the needs of an expanding economy. Federal receipts should be sufficient over a period of years to balance the budget and provide a surplus for debt reduction. At the same time, the tax structure, and the changes made in it from time to time, should be such as to promote the amounts and types of investment, consumption, and saving needed for economic expansion. We should recognize that the expansion of the economy will generate additional revenues and strengthen the fiscal position of the Government.

Fifth. We must deal vigorously with trouble spots which exist in our economy even in times of general prosperity.

Special measures are needed to help low-income groups and, even more important, to provide them with better opportunities to help themselves. We must deal with the particular problems of communities or areas which are depressed, or whose economic growth has been retarded. Whenever a shortage of jobs, or lack of business opportunity, affects as many persons as it does today, it is a matter for national concern. Economic stagnation anywhere is an injury to the whole economy. We must direct specific measures to these special problems.

In the light of these guiding principles, I turn to the consideration of needed economic policies. . . .

The Report again recommended a wide assortment of controls. The rate of economic growth had slackened without a corresponding decline in Federal spending, and so the national debt had increased. The Report included recommendations for legislative action, and these are summarized below (p. 16).

I summarize below the legislative recommendations contained in this Economic Report, and urge that the Congress enact them into law:

1. Make some revisions in the tax structure to reduce present inequities, stimulate business activity, and yield a moderate amount of net additional revenue. My specific recommendations on taxes will be transmitted to the Congress at an early date.

2. Enact a new program to stimulate private investment in housing for middle-income families.

3. Substantially increase the maximum maturity period for business loans made by the Reconstruction Finance Corporation.

4. Improve the protection of farm incomes and encourage needed shifts in farm production, by authorization of production payments and other changes in present legislation.

5. Establish a Columbia Valley Administration, and authorize the St. Lawrence seaway and power project.

6. Provide for Federal aid to elementary and secondary educa-

tion, for a limited program of aid in support of higher education for capable students, for aid to medical education, for the improvement of local public health services, and for grants to States for surveys of the need for school construction.

7. Extend and liberalize the social security structure by improving old-age, survivors, and unemployment insurance, enacting disability and health insurance, and expanding Federal grants-in-aid to States for public assistance.

8. Extend rent control for another year.

9. Continue the foreign recovery programs on a basis commensurable with need.

10. Approve the Charter for the International Trade Organization.

11. Authorize the program for technical assistance to underdeveloped countries, and for guarantees by the Export-Import Bank against risks peculiar to private investment abroad; and revise certain provisions in the tax laws governing the taxation of income from foreign investments.

12. Provide additional authority over banking reserves to the Board of Governors of the Federal Reserve System; extend that authority to all banks insured by the Federal Deposit Insurance Corporation; and restore the Board's authority to regulate consumer credit. Provide authority to regulate speculation on the commodity exchanges. . . .

Report of the Council of Economic Advisers, 1950

Although the Council's Report contained significant discussions of numerous topics, such as the course of the economy, the respective roles of wages, prices, and profits, and the sources of economic growth, we are using only a few samples of these analyses, depicting the part played by the private sector, the role of prices, and the importance of fiscal policy (pp. 99–100 and 103–106).

The early reversal of the downturn in 1949 was accomplished with the aid of a composite of private and public policies. The Council has stressed the importance of policies in the business world itself, coupled with our confidence that as these policies constantly improve there will be progressively less likelihood of the drastic Government action which follows from the emergence of critical conditions.

Government should also exert an affirmative influence if we are to accomplish the objective of steady economic growth. The Government has become a large partner in the modern productive process by contributing to the development of resources, transportation, research, and the productivity of labor, all of which are essential to an expanding economy. Tax and credit programs have an immense impact upon the flow

of incomes and funds, and upon the decisions of business and consumers.

The following treatment includes an appraisal of some of the measures which are significant for economic growth and stability under current and foreseeable circumstances. This treatment does not attempt to be all-inclusive. For example, other programs (such as those involving the power to deal broadly and flexibly with credit developments through the Federal Reserve System) should be made available to be used if conditions sufficiently change to call for them. Still others may need to be developed if deficiencies in market adjustments unfold.

What is recommended now might appear as a piecemeal approach, were not each piece appraised in the perspective of the current economic situation and of the general objectives defined for the years immediately ahead.

The Function of Prices

Our economy is sometimes called a price economy. This means more than that changes in particular prices influence the decisions which determine the kinds and volumes of goods which are produced. It also means that the price factor exercises so important an influence upon levels of real profits and real wages and other incomes that it vitally affects the economic balance between investment and consumption which is essential for a high level of general activity.

The current price level in general is now high enough to sustain a generally rewarding level of profits, if activity is high, and this level of profits would increase substantially if the volume of sales approaches the levels required to sustain maximum production. For this reason, there would be no justification for a general upward movement of prices, and neither the current nor shortly prospective relationship between supply and demand is likely to force general prices upward. While our economy is so complex that a few isolated upward adjustments may seem justifiable, every effort should be made to avoid them, because they will not add to stability or confidence and will make it harder to achieve a level of sales consonant with maximum production and employment.

There are some prices which are too high to permit continuance for a long period of the current volume of sales. These prices will need to be reduced or production and employment will eventually suffer. These prices are in the field of the administered-price industries where price policy is firmly controlled; but it may be expected that managers in these industries will not fail to reach for the larger market demand which will follow price adjustments.

The Council believes that in general—and noting the exceptions mentioned above—the price level is now within a range where stability should be feasible at workable levels. By workable levels, we mean those which will enable buyers, as incomes rise gradually in a growing economy, to increase their purchases sufficiently so that maximum production and employment will be achieved and maintained. We feel that, with

respect to the general situation, it will be safer for the immediate future to depend mainly upon income adjustments rather than upon sweeping and widespread price adjustments to enlarge the volume of demand.

This is not to say that a long-run downward trend of some prices in those areas where technological gains are unusually great, or where productivity increases with extraordinary rapidity, is not one of the best ways of enabling these gains to be enjoyed by the whole population instead of merely by a specific group of income recipients. Such trends in some prices have appeared in the past and will appear again, and they are all to the good. Nonetheless, as a general proposition serving as a guide to economic policy, the practical dynamics of our economy indicate that a fairly stable general price level and a rising level of money income as productivity increases are more conducive to business confidence and to the expansion of enterprise than a generally declining price level.

The Council is mindful of the critical problems confronting those whose incomes have remained at low or moderate levels fixed since before the war. But without a serious and prolonged downturn throughout the economy, the price level could not conceivably be reduced to the point where these people would find themselves in a satisfactory position. And that very process of downturn would hurt many of them as much as anybody else. These people, if they are to progress, must look to income gains. . . . .

Fiscal Policy

In its Fourth Annual Report to the President, published last month, the Council stressed the contribution which a reasonably stable fiscal policy could make toward general economic stability and growth. But we recognized that drastic changes in expenditure and tax programs of Government had been necessitated by the appearance of wars and depressions. We also recognized that the large tax changes in 1948, the condition of the Federal budget, and the rapid shifts in business trends in 1949, call for some tax changes very soon. Further, some improvements in the tax structure are needed before a sound base will be established on which to rest a long-range effort to achieve more stability in fiscal policy.

The level of taxes did not prevent a magnificant record of postwar economic achievement. A valuable result of the Government surpluses in 1947 and 1948 was in helping to restrain the forces of inflation. The subsequent downturn in business activity during the first half of 1949 was not due to execessive taxation. Nor did the level of taxation prevent the upturn in business activity from coming sooner after the beginning of the downturn than in any comparable period in the past. Turning to the expenditure side, while the high outlays necessitated by the international situation complicated the inflationary problem until early 1949, the steadiness of these outlays cushioned the downturn very substantially. On the other hand, the Council at midyear 1949 did not recom-

mend increases in public spending for the purpose of stimulating the economy, and our confidence in its internal recuperative forces has thus far proved justified. . . .

Expenditure policy

The prime purpose of Federal expenditure is to furnish those services which cannot be provided effectively in any other way, and which are necessary to our national security, welfare, and progress. Examination of the Federal Budget indicates that outlays are reasonable by this test. Outlays for national defense and international affairs are higher than they would be in a more peaceful world, but the fact must be accepted that their present level is determined by security reasons. Growing international stability will permit a progressive decline in these types of outlays. The proposed increases in social insurance programs and in other welfare and developmental programs reflect recognized needs and conform to the clearly expressed purpose of the people.

The level of current and proposed public outlays will not impose an undue inflationary strain upon the economy as a whole. Our economy is now functioning at high levels, but considerably below maximum employment and production or full utilization of its resources, and in the Council's judgment there is no presently foreseeable prospect that a renewal of general inflation will require that Government programs be cut below essential requirements. On the other hand, we do not now believe that current and proposed Government programs should be expanded above their contemplated rate merely in order to take up the slack in employment. We should instead rely upon the recuperative forces now at work.

There is no previous experience with an economy of the size that ours has now reached, from which there may be drawn any firm rule as to the proportion of the national income which may safely in the long run be channeled back into the economic stream through the Government. But the Council's whole approach focuses upon the objective of economic expansion through the enlarging activity of consumers and of business, and this means that Federal expenditures should be held as low as the requirements of programs essential to national growth and welfare will permit.

Because so large a proportion of present Government programs is devoted to purposes which, while essential to national security and world political stability, make little direct contribution to increased standards of living, we wish to emphasize the desirability of working toward lower levels of expenditures as rapidly as international conditions permit. We also wish to emphasize the importance of constant vigilance against the dangers of waste and inefficiency everywhere and at all times. Measures of economy, however, must not be so distorted in application as to involve the sacrifice of essential objectives.

For this reason, we have expressed the hope that world conditions will

make it possible to make a steady reduction in national security and other extraordinary expenditures related to the itnernational situation, for it is here and in related activities arising from the war that there lies the greatest opportunity for future reduction in the Federal budget. . . .

Balancing the budget by attaining a surplus in periods of high business activity to offset deficits which might appear under less favorable conditions is, in our opinion, an important policy. . . .

President Truman's Economic Report of 1951

The 1951 Report reflected the problems associated with the Korean War, as indicated by the statement that ". . . we face enormously greater economic problems . . . than at any time since the end of World War II. Although our economic strength is now greater than ever before, very large new burdens of long duration are being imposed upon it. The United States is pledged and determined, along with other free peoples, to check aggression and to advance freedom."

The Report described the nature of the task and reviewed the power of the economy to answer the challenge.

Fear of inflation was one of the dominant concerns at that time. The Report paid special attention to the need for the formulation of effective governmental policies to speed up the production effort, yet to provide for economic stability at the same time. A program of taxation was suggested that was designed to place the cost of financing the war as nearly as possible on a "pay-as-you-go" basis. The following selection indicates the nature of the concern over inflation (p. 6).

THE INFLATIONARY DANGER

While it is clear that we have the productive ability to meet even far greater defense demands on our economy, we must not be misled into thinking that we can make the change to a defense economy easily. It will require effort, restraint, and sacrifice by all of us.

The character of our economy must now be changed rapidly to meet the new challenge. Those types of production which support the expanding defense effort must be greatly enlarged. The part of our total national output going into defense should rise from 7 percent to nearly 18 percent, during the year 1951. By the end of the year, the expanding defense program may be absorbing one-third or more of some basic materials.

In some respects, it will be harder to convert to defense production than it was in 1940. Then, there were idle plants and men and materials which could be channeled into the defense effort. Since our economy has recently been running full blast, the defense program will have to pull men and materials, as well as plants, away from existing peacetime uses. This will pull millions of people away from normal peacetime production.

Although we can increase production, we cannot do it quickly enough to expand the defense program, and at the same time still have as much left over for other purposes. We must put heavy restraints upon nonessential business activity. During the past few years, nearly 70 percent of our growing national output has gone into consumption. This has led to higher standards of living, which is the ultimate purpose of a peacetime economy. But the total supply of consumer goods cannot be increased this year, and many types of goods must be sharply curtailed. Yet the population will continue to grow; new families will continue to be formed; and more incomes for practically all groups will be generated by more production, more employment, and longer hours. The excess of consumer demand over available goods will rise by many billions of dollars.

This will cause intense and mounting inflationary pressures, which must be counteracted.

Report of the Council of Economic Advisers, 1951

The Council's Report accompanying the 1951 President's Report analyzed a number of leading issues associated with the Korean War. Special attention was given to the impact of the war effort on civilian consumption and to the emergence of inflationary pressures. A sample of the Council's thinking is presented below, taken from its discussion of the economic policies for defense (pp. 84–86).

Three Requisites for Economic Mobilization

There are three indispensable requirements for an efficient economic mobilization, whether partial or total. The first need is for a thoroughly comprehensive and unified programming operation, to balance competing requirements against available supplies. Such programming is essential to all policy, whether designed to direct resources to the highest priority uses or to avoid disruptive inflation. The second need is for utmost speed in accomplishing defined objectives. The third need is to conduct the economic mobilization program with a determination and fairness which elicit general support from a public kept fully informed of the nature of the program and its implications.

The need for comprehensive programming

Economic mobilization means a vast and rapid shift in the use of our resources, to which every policy must be attuned. This shift is executed throughout the economic system. But in the very nature of a defense emergency, the Government must outline the basic needs and project the major policies to satisfy them. The essentiality of a complete and always current programming operation does not depend upon "full mobilization." The importance of a clear definition of *what* needs to be done does not depend upon *how much* needs to be done. In some re-

spects, partial mobilization requires an even greater clarification of objectives than full mobilization.

The definition of all major requirements necessarily draws its frame of reference from the primary military program, because it is the military build-up which is at the core of the whole effort. More and more precision should be sought, as rapidly as feasible, in the definition of what our primary defense goals are at any particular time. And for the purposes of economic adjustment to these primary goals, requirements in terms of manpower and materials are obviously more important than requirements in terms of dollars. This emphasis is not inconsistent with realization that primary military objectives must remain reasonably fluid, and that for security and other reasons they cannot be revealed in full even where they have become crystallized.

But it would be dangerous to assume that all other aspects of economic programming can be delayed until primary military programming reaches any particular point. There is an interrelationship between the two, which requires to a considerable degree that they move forward simultaneously towards ever-improving clarification. Nor is it true that the other aspects of economic programming consist solely in saying that whatever is not taken for military purposes is available for other uses. These other uses must in turn be subjected to constant programming, because some of them promote our security and others do not. Our security in the long run depends upon how we divide available resources between maintenance and improvement of our national plant and tools on the one hand, and ultimate consumer needs on the other. Within the industrial structure, it depends upon what kind of activities we carry forward vigorously and what kind we cut back. Above all, there should be a balance of how much we seek to achieve through cutbacks and restraints, as against how much we seek to achieve through expansion of total production.

The early experience during World War II afforded eloquent proof that the greatest obstacle to over-all efficiency was the slowness in developing a useful and comprehensive programming operation, and locating it ultimately at one point of authority. The Council now urges that the first steps already taken in this direction be carried as quickly as practicable to their logical conclusion. This does not mean that detailed operations cannot be paracelled out; but it does mean that the ultimate "budgeting" of our resources for defense should be centralized. Budgeting, which is a process of reconciliation of competing requirements, cannot be done in several separate places.

The need for speed

Speed is of the essence in economic mobilization. This sound principle should not be confused with the question of the size of targets. Speed does not mean, for example, that we should as rapidly as possible achieve total mobilization; that is a matter of grand strategy. Nor does it mean

that mobilization should not proceed in an orderly fashion, with speed concentrated first on the earlier steps and later on the subsequent steps of the program. But speed does mean that decisions as to targets should be reached as quickly as possible, and that every effort should be made to attain whatever targets are decided upon as rapidly as the basic program calls for.

In economic mobilization, tardiness has a cumulative effect because of the interrelationship among all the parts. Delay at one point generates even more delay at succeeding points. Indecision at one point promotes apathy at another. As an apt illustration, there may be debate as to when the Government should apply price controls over a given commodity. But once the Government has announced or intimated that it is going to do so, delay in accomplishing the result can only add fuel to inflation, speculation, and an enervating let-down on the part of the general public. Conversely, demonstrated celerity at one point awakens others more fully to the urgency of the situation and consequently accelerates their own necessary actions. Since our nation is now undertaking to catch up with the mobilized military strength of the aggressors, every day is precious. . . .

The promotion of economic stability was emphasized in the 1951 Report as a feature of national policy in spite of the mobilization requirements. Selective credit controls, taxation, and debt management were highlighted as effective tools. Attention was called to the fact that the nation, in spite of the war burden, continued to have an international economic role and responsibility.

The mid-year report went further into the areas described in the January Report. Because of the burden of the Korean War, however, the Report was concerned primarily with building the national defense. As such, it became one of the longest reports—approaching 300 pages.

President Truman's Economic Report of 1952

The 1952 Report also was characterized almost exclusively by considerations of war and national defense. The Report began by analyzing the task for the nation and pointed out that, in spite of the increasing defense burden, the economy had grown stronger during 1951. Top issues for public policy were reviewed. These included improving defense strength, continuing aid for other nations, expanding production facilities, controlling inflation, increasing taxation, and stabilizing wages. To help achieve these objectives a series of legislative recommendations was made (p. 25).

1. Renew the Defense Production Act for two more years, and strengthen its provisions, particularly those relating to production expansion and to the control of prices and credit.

2. Provide continued military and economic aid to free nations; and, as a step toward removing trade barriers, repeal Section 104 of the Defense Production Act, which restricts our imports of certain goods which European and other countries could export to us on mutually advantageous terms.

3. Aid small business by providing the necessary funds for the Small Defense Plants Administration.

4. Provide for certain urgently needed development projects, particularly the St. Lawrence seaway and power project.

5. Provide for the construction of needed housing and community facilities in defense areas.

6. Revise the basic legislation concerning labor-management relations, so that it will not hamper sound and healthy labor relations and uninterrupted production.

7. Repeal the sliding scale provisions in existing agricultural price support legislation; provide a workable support program for perishable commodities; and modify the tax on unallocated reserves of farmer cooperatives.

8. Provide at least enough additional revenues to reach the revenue goal proposed last year, by eliminating loopholes and special privileges, and by tax rate increases.

9. Provide powers to the Board of Governors of the Federal Reserve System to impose additional bank reserve requirements; and provide authority to control margins for trading on commodity exchanges.

10. Raise the level of benefit payments, and make other improvements, in our system of old-age and survivors insurance; and strengthen the Federal-State unemployment insurance system.

11. Authorize Federal aid to help meet school operating costs, and increase aid for school construction and operation in critical defense areas.

12. Authorize Federal aid to assist medical education, and provide for strengthening local public health services.

The Council of Economic Advisers began its 1952 Report by examining the economic strategy of the defense program.

More specific attention was given to the security build-up and its effects on production, employment, prices, wages, profits, credit, money supply, investment, finance, international transactions, and fiscal operations.

Among the central problems for 1952, the Council listed the following: advancing the national security, allocating scarce resources, increasing production, minimizing business dislocation, supplying consumer needs, helping to strengthen other free nations, financing the government's program, and maintaining economic stability.

The policy recommendations were much the same as contained in the prior reports. The mid-year Report for 1952 was the last time that a mid-year report was issued. It continued to detail the defense problems and outlined the progress being made to strengthen the economy.

President Truman's Economic Report of 1953

The 1953 Economic Report was the last for President Truman and marked the end of a series of reports reflecting the economic policies of the Democratic Party. This Report again was influenced by the demands of the Korean War.

The Report began with a general review of the American economy during the preceding quarter-century emphasizing the advances in production, jobs, and welfare that had taken place.

Performance under the Employment Act to date was reviewed, and a portion of this record is shown (pp. 8–11).

Purpose of the Act

The Employment Act of 1946 is one of the most fundamental compacts in domestic affairs which the people through their Government have made during my tenure as President. It represents the refusal of Americans in all pursuits—in business, labor, agriculture, and Government—to accept recurrent depression as a way of life. It voices a profound conviction that all of us—working together—can maintain and enlarge prosperity, not only during or as an aftermath of war, but enduringly for all time.

The Act is more than an essay in wishful thinking. It represents the closely reasoned conclusion of economic minds, both scholarly and practical, that its objectives are obtainable by sensible private and public policies and can best be sought within the framework of our established political and economic institutions.

There were historical roots for this endeavor. The lessons of the past had been particularly compelling in the decade and a half which preceded 1946. These had been years of unprecedented contrasts, so far as economic abundance was concerned. On the one hand, there was the stark tragedy of the early thirties, and then the seemingly boundless energies of the early forties. The period had been rich in careful social experimentation and legislative reform: the economic role and responsibilities of the Federal Government had increased enormously. Many of the experiments had been temporary in character, to meet the emergencies of the depression or the extraordinary demands of war. But many of them were developed and improved to become permanent additions to our economic and social fabric.

Yet the Employment Act was not written in a spirit of conflict. It was not focused on the interests of any one group, whether powerful or downtrodden, but was addressed explicitly to the general welfare. And to an

amazing degree, when one considers the thinking which it marked, it was noncontroversial. The subcommittees of the Senate and the House which skillfully ushered it into the legislative world worked to a large extent as bipartisan teams, and the final bill commanded overwhelming majorities of both parties in both houses of the Congress.

There are those who have suggested from time to time that, because the Act was relatively noncontroversial, it cannot have been very consequential. This is erroneous. Near unanimity, in this instance, was not a mark of the unimportant or the hackneyed; it was evidence that a legislative proposal of the greatest moment was extraordinarily well timed. It wrote into the codes of the Nation a great new area of agreement about the essential functions and responsibilities of the Federal Government almost as soon as that agreement existed.

It is likewise a mistake to underestimate the importance of the Employment Act, as some have done, because it did not set down a specific prescription of economic policies for solving future economic problems. The decision of its framers in this respect was deliberate, and did not represent simply an inability to get agreement on more technical or specific provisions. Instead, the decision was that such basic legislation should not attempt to prejudge the exact character, cause, and remedies of all of the future's general economic problems, but rather to define the general spirit and provide the general method for meeting these problems as they arise. With these problems in view, the Act has three specific purposes.

First, it is the purpose of the Act to achieve, within the Congress and the Executive Branch, and also between private enterprise and all levels of government, better economic policy coordination. In the thirties, and again during World War II, the economic programs of the Government had become increasingly diverse and complex, and any realistic appraisal indicated that they would remain so. The special pressures which were brought to bear upon public economic policy-making had become more powerful, more numerous, and more confusing.

But this growth of complexity had not been matched, especially within the permanent institutions of the Government, by the development of adequate means for gauging whether our farm programs, developmental programs, international trade policies, tax policies, credit policies, business regulatory policies, industrial relations law, and the rest, were consistent with one another and fitted together into a sensible economic policy for the over-all economy. In the thinking of Congressmen from particular sections and on particular committees, and of leading administrators with specialized responsibilities, the whole too often was lost in preoccupation with the parts.

The governmental reforms in the Employment Act have sought to meet this problem by strengthening the President's facilities for economic policy coordination within the Executive Branch, by supplying the Congress with a similar facility, and by providing in the Economic Report a regular method for improved coordination between the two branches.

Thus the Act meets the problem squarely within the framework of our constitutional system of separated powers. Instead of attempting to circumvent the system with a hybrid agency which would be clearly responsible neither to the Congress nor the President, it installs a mechanism intended to make the traditional system work better. And it provides also, by requiring consultation with business, farm, labor, consumer and other groups, for cooperation and coordination between private and public economic thought and action.

Second, it is the purpose of the Employment Act—the one most widely recognized at the time of its passage—to prevent depressions. As World War II drew to a close, recollections of the shocking costs of the great depression were much sharper than they are today after a dozen years of uninterrupted high prosperity.

The minds of most of us in 1946 were still deeply etched with the memory of the winter of 1932–33, when about 15 million American workers, or about 30 percent of the total civilian labor force, had no jobs; when industrial production was only half what it had been in 1929 and the total output of the economy only about two-thirds; when business was deep in the red; when farm prices and incomes had dropped out of sight; and when banks were collapsing by the hundreds. It has been calculated that the depression cost us some 600 billion dollars of output, measured in 1952 prices, or 8½ times everything we produced in 1929.

The Employment Act stands as a pledge on the part of the people voiced through their laws that never again shall any such sacrifice be laid on the altar of "natural economic forces." In the bigger economy we now have, a disaster of anywhere near the same proportions could mean some 20 millions of our workers walking the streets.

Moreover, the cost of another serious depression would not stop at our own borders. What was becoming apparent in 1946 is now a reality: the strength and stability of the whole free world depend on the avoidance of economic collapse in this country.

Third, the Employment Act had still another clear purpose even more profound and challenging than those of improving economic policy coordination and preventing depressions. It is one which carries beyond the essentially negative and intermittent objective of counteracting slumps. It is the positive resolution of a great people, not simply to avoid pitfalls, but to maintain as a matter of continuing policy a full, bountiful, and growing economy, for themselves, for their children, and as a standard and inspiration toward the freedom and welfare of all peoples—and to do this in full peace no less than in limited war.

This is a purpose of which we must never lose track. The Act is not meant simply for salvage operations; it does not set up a standby mechanism to be brought onto the scene only on those extreme occasions when the economy needs to be dredged out of a hole. It symbolizes the marshaling of the forces of private and public policy in support of a full and growing economy.

In such an economy, performance is not measured in the dimension

> of employment alone; instead, a dynamic, growing productive potential enables us to provide a steady expansion of output as well as full employment.
>
> In such an economy, expansion facilitates the spread of economic justice, and the quality of the expansion is measured in terms of justice as well as efficiency.
>
> In such an economy, there is abundance and stability enough to permit an increasing devotion of energies to the higher values. More and more people, being able to take the needs of their stomachs for granted, can devote increasing attention to the needs of their minds and hearts.

For the future, President Truman recommended the following policies: full employment must be a constant objective of public policy; economic balance must be maintained; planning must be kept up constantly; there must be a balance between the private and public sectors; there must be a balance between individual and group interests; and war is not the source of economic strength.

3. A REVIEW OF PRESIDENT EISENHOWER'S REPORTS (1954-1959)

President Eisenhower's Letter of Transmittal, 1954

WITH HIS FIRST economic report, presented in 1954, President Eisenhower changed the format. Instead of a lengthy preface, summary, and report of his own preceding that of the Council, President Eisenhower used a brief letter of transmittal to Congress. His first such letter was very precise and succinct. It indicated national objectives, described the role of government, explained why there was a real basis for confidence, and recommended measures to strengthen the economy. Part of the 1954 letter of transmittal is reproduced below (pp. III–V).

Role of Government

The demands of modern life and the unsettled status of the world require a more important role for Government than it played in earlier and quieter times.

It is Government's responsibility in a free society to create an environment in which individual enterprise can work constructively to serve the ends of economic progress; to encourage thrift; and to extend and strengthen economic ties with the rest of the world.

To help build a floor over the pit of personal disaster, Government must concern itself with the health, security and welfare of the individual citizen.

Government must remain alert to the social dangers of monopoly and must continue vigorous enforcement of the anti-trust laws.

Government must use its vast power to help maintain employment and purchasing power as well as to maintain reasonably stable prices.

Government must be alert and sensitive to economic developments, including its own myriad activities. It must be prepared to take preventive as well as remedial action; and it must be ready to cope with new situations that may arise. This is not a start-and-stop responsibility, but a continuous one.

The arsenal of weapons at the disposal of Government for maintaining economic stability is formidable. It includes credit controls administered by the Federal Reserve System; the debt management policies of the Treasury; authority of the President to vary the terms of mortgages carrying Federal insurance; flexibility in administration of the budget; agri-

cultural supports; modification of the tax structure; and public works. We shall not hesitate to use any or all of these weapons as the situation may require.

The Current Situation

The year just closed was very prosperous with record output, widely distributed incomes, very little unemployment, and prices stable on the average.

In the second half of the year there was a silght contraction in business leading to unemployment in some localities. This was due mainly to a decline in spending by businesses for additions to inventory. Other categories of spending, notably retail sales, have been well sustained.

Our economic growth is likely to be resumed during the year, especially if the Congress strengthens the economic environment by translating into action the Administration's far-reaching program. . . .

Measures to Strengthen the Economy

To protect and promote economic stability we should take bold steps—by modernizing unemployment insurance; by broadening the base and benefits of old-age insurance; by permitting a longer "carry-back" of losses for tax purposes; by granting broad discretionary authority to the Executive to alter, within limits and appropriate to changing circumstances, the terms of governmentally insured loans and mortgages; by establishing a secondary home mortgage market; and by making improvements in the planning of public works programs.

To stimulate the expansive power of individual enterprise we should take action—by revising the tax laws so as to increase incentives and to remove certain impediments to enterprise, especially of small business; by improving credit facilities for home building, modernization, and urban rehabilitation; by strengthening the highway system; and by facilitating the adjustments of agriculture to current conditions of demand and technology.

Eisenhower's Economic Report reviewed economic conditions in 1953, paying special attention to overall trends, the contraction of 1953, movements in prices and wages, and international transactions. For the first time, the United States experienced a deficit in its current accounts, but this was offset by surpluses elsewhere in the payments record.

The Report then reviewed the nature of governmental policy in a year of much change. In view of the increase in economic activity associated with the Korean War, much of the attention of public policy was focused on the prevention of inflation. A flexible monetary and fiscal policy was called for in view of the potential rapidity of change in the economic picture.

In spite of the fears of inflation, the Report emphasized the need for a thorough reform in the tax structure to eliminate many restrictive features of the tax system at that time. Other policy recommendations included greater equity to consumers, encouragement of free enterprise and employment, increasing economic stability, aid to housing and finance, and a reorientation of the policies toward both agriculture and social welfare.

Following the Report was a discussion of the role of government in economic progress. The description began by indicating how important progress is for a dynamic nation and then went on to indicate how government could stimulate and provide a climate for continued progress by promoting effective competition, savings, and capital formation; by aiding research and development; by adopting policies that would lead to economic stabilization; by assuring individuals a minimum floor of economic security; and by participating in the world economic community, especially through efforts to promote freedom of international trade.

President Eisenhower's Economic Report of 1955

The 1955 Economic Report of President Eisenhower was the first that reflected the post-Korean War readjustments. His letter of transmittal set the tone of the Report, and it emphasized the role of the private sector, as it outlined the course of recent economic progress. The expansive powers of the American economy were stressed. The year 1954 was described as one of transition beginning with a contraction partly associated with the readjustments after the end of the Korean hostilities. By the end of 1954, signs of a recovery and expansion were in evidence. The contraction, which had begun in 1953, proved to be mild. Much of the credit for keeping it mild was given to Federal policies, especially of a fiscal and monetary type.

A program for sustained economic progress was outlined to include a flexible fiscal program, aid to new and small business, a freer international trade program, building a floor for personal and family security, augmenting low incomes, improving homes and neighborhoods, increasing the stability of the economy, and expanding public works when necessary.

Leading economic developments during 1954 were included in an appendix. Another appendix summarized the recommendations of the report as follows (pp. 69–71):

> The following summary of recommendations in the Economic Report includes recommendations to the Congress and suggestions to the States and municipalities.

Taxes, Business Regulation, and the Public Debt

1) Postpone the lowering of the corporate income tax and of excises, scheduled for April 1, 1955.
2) Reduce the tax rate on corporate income from all foreign sources by 14 percentage points.
3) Permit corporations with foreign branches to defer the tax on branch income until it is withdrawn from the country in which it was earned.
4) Allow a regulated investment company, holding the bulk of its assets in the form of tax-exempt securities, to pass through to its shareholders the tax-exempt status of the income from such securities.
5) Strengthen the deterrent to violation of the Sherman Antitrust Act by raising substantially the maximum fine that may be imposed under the Act.
6) Increase the present statutory debt limit to permit greater flexibility in the management of Federal finances.
7) Review State and local tax-rate and debt limiting statutes with a view to removing or relaxing, where advisable, these barriers to local public investment. (State responsibility)

Unemployment, Pensions, and Minimum Wage

8) Amend the unemployment insurance law of the District of Columbia to provide 26 weeks of benefits for all persons who qualify and who remain unemployed that long, and review disqualification provisions.
9) Strengthen the Federal-State Employment Service.
10) Extend the coverage of Federal Old-Age and Survivors Insurance, on a permanent and full contributory basis, to Federal personnel.
11) Consider including under the unemployment insurance system the employees of State and local governments, and employees who work for firms employing fewer than four persons, to the extent that these workers are not now covered. (State responsibility)
12) Consider revising unemployment insurance benefits so that (a) the great majority of covered workers are eligible for payments that at least equal half their regular earnings, and (b) the term of unemployment insurance benefits is 26 weeks for every person who qualifies for any benefit and who remains unemployed that long. (State responsibility)
13) Expand the Area Development Program of the Department of Commerce, which is designed to help depressed communities.
14) Increase the Federal minimum wage to 90 cents an hour; consider extending the coverage of a minimum wage to substantial numbers of workers now excluded. (Congressional and State responsibility)

Education and Public Improvements

15) Expand Federal programs for fellowships, research, teacher training, and related activities.

16) Take early steps to help relieve the classroom shortage that now exists in our schools. (Congressional and State responsibility)
17) Modernize over a ten-year period the presently-designated National System of Interstate Highways.
18) Appropriate funds to set up an Office of Coordinator of Public Works Planning within the Executive Office of the President.
19) Enlarge the appropriation for planning advances to States and municipalities, and establish a revolving fund for the purpose.
20) Study the problems of metropolitan areas, so that area-wide transit systems, sanitation systems, water supplies, or educational facilities may be provided with maximum returns from public funds expended. (State responsibility)

Housing and Finance

21) Increase the insurance authorization of the Federal Housing Administration.
22) Give the President greater latitude in the exercise of his power to vary, in the light of economic conditions, the terms on which home mortgages are underwritten by the Federal Government.
23) Allow national banks to make conventional real estate mortgage loans with maturities up to 20 years, and to extend the maximum duration of construction loans.
24) Take steps to expedite urban renewal plans, so as to obtain available Federal assistance. (State responsibility)
25) Consider, where necessary, enacting legislation to permit the writing of "open-end" mortgages. (State responsibility)
26) Authorize the Public Housing Administration to enter into contracts for 35,000 additional units of low-rental public housing in each of the next two fiscal years.
27) Continue the program for helping business concerns of small size to obtain access to adequate financing, to a fair share of Government procurement contracts, and to competent counsel; and extend the program's lending authority.
28) Consider the merits of share-account insurance and other measures for protecting savings in credit unions.

International Economic Relations

29) Extend the Trade Agreements Act, subject to present escape and peril point provisions, for three years with amendments to empower the President: (a) to reduce present tariff rates on individual commodities by as much as 5 percent per year in each of the three years; (b) to reduce tariff rates in greater degree in the case of products now imported in negligible volume; and (c) to reduce to 50 percent any rate in excess of that level.
30) Establish standards for the valuation of imported goods that are simple, clear, and logical in their application.

31) Increase the duty-free allowance of foreign goods brought home by tourists during any six-month period.
32) Authorize at the proper time a contribution to the capital of the proposed International Finance Corporation.
33) Strengthen the program of technical and other assistance to economically undereveloped countries.

President Eisenhower's Economic Report of 1956

The 1956 Report of the President emphasized the importance of the private sector in stimulating the expansion of the economy. The letter of transmittal sending the Report to Congress emphasized this belief, as did a number of special sections in the Report. To be sure, this emphasis did not intend to imply that there would be no place for the Federal government. In fact, the Report indicated that a greater role for government is being dictated by the ever-dynamic nature of economic growth and the constant change in the nature and operations of the institutions that guide the economy. How these roles are brought together is indicated in the following excerpt (pp. 6–8):

> Many factors have been quietly adding to the strength of our economy, and the current expansion is fundamentally an expression of their cumulating force. Among these factors are the unexpectedly large upsurge of population in the past decade, the continued growth of scientific knowledge, the onrush of technology, the rapid obsolescence of what is sometimes regarded as fixed capital, the recent development of long-range investment planning by industry, the improved control over inventories, the intensified pace of business competition, the wide diffusion of well-being among people, their insistent and growing desire to earn more and live better, the development of mass markets to match mass production, the rebuilding of Western Europe, the general recognition of government's responsibility in helping to maintain a stable prosperity, and the growing understanding that public policy must protect economic incentives if enterprise, innovation, and investment are to flourish. All these factors are and probably will continue to be basic to our progress, but several of them are especially noteworthy in the current situation.
>
> The recent expansion of our economy has occurred in an environment of growing production and trade in the Free World. Western Europe, in particular, has gained a level of economic well-being hitherto unknown on the Continent. Production and incomes have been rising rapidly. Unemployment has virtually disappeared in Great Britain, and is low everywhere except in Italy. Barriers to trade and currency movements have been reduced. Private enterprise and competitive markets are again widely respected. These improvements in conditions abroad have reinforced our prosperity at home.
>
> The Federal Government has played a constructive part in the pros-

perity that the American people are now experiencing so widely. It has not, however, sought to maintain good times by expanding our already huge governmental outlays or by permitting the value of money to depreciate. Recognizing that these alluring short cuts to a high level of economic activity have all too often brought disaster to nations, our governmental policies have concentrated on building an economic environment that favors an orderly expansion of private activities.

The demands of modern life and the continuing threat of Communist aggression require a much higher level of taxes and a larger role of Government in economic affairs than suited earlier generations. This very fact imposes a responsibility on the Government to pursue policies that will help to keep the private economy strong and growing. The Administration has sought, in cooperation with the Congress, to discharge its responsibility through a series of closely related policies. First, by removing direct controls over prices and wages, which had outlived their usefulness. Second, by preserving an actively competitive environment and assisting new and small businesses. Third, by curtailing governmental activities that could be handled as well or better by private enterprise. Fourth, by restricting public expenditures, and yet adding to the country's defensive strength and its stock of public assets, especially highways, hospitals, and educational facilities. Fifth, by lightening the burden of taxes imposed on individuals and businesses. Sixth, by extending the ties of trade and investment with other nations of the Free World. Seventh, by tempering the impact of unemployment, old age, illness, and blighted neighborhoods on people, yet not impairing self-reliance. Eighth, by extending the automatic workings of our fiscal system that tend to offset or cushion changes in income arising from changes in economic activity. Ninth, by attacking fundamental causes of weakness in the farm situation. Tenth, by acting promptly and resolutely when either recessionary or inflationary influences in the general economy became evident.

By recognizing the vital importance in our times both of free enterprise and of a sense of economic security, these directions of governmental policy have served to enlarge the horizons of businessmen, workers, investors, and consumers, and have stimulated people to bolder economic actions and undertakings. This, in essence, has been the Government's role in the recent expansion. . . .

President Eisenhower's 1956 Report argued that it is quite possible to have prosperity and general price stability at the same time. To attain this objective, however, certain governmental policies were called for, such as: flexible monetary and fiscal programs, holding the tax line, shifting from active credit ease to moderate restraint, instituting effective controls over consumer and housing credit, and adjusting the stockpile program. Specific recommendations to broaden the scope of the prosperity covered promoting agriculture, helping local areas re-

duce unemployment, lifting income by raising productivity, improving the economic status of the elderly, and generally relieving personal hardships.

To build for the future, the Report called for preserving sound Federal finances. fostering competitive enterprise, extending home ownership and improving neighborhoods. enlarging public assets where necessary. improving skills and technology, and increasing the stability of the economy while it is expanding.

All of these recommendations were made within the framework of the free enterprise system.

President Eisenhower's Economic Report of 1957

The letter of transmittal presenting Eisenhower's 1957 Report was a bit longer than the earlier ones, and once more stressed the importance of the institutions of the free enterprise system.

The Council's Report was briefer than the preceding ones, although several appendices were added to the report. Similar to the President's letter of transmittal, the body of the Council's Report also emphasized the efficacy of the free enterprise economy.

The Report examined the economic growth and improvement for the period 1953–1956. Recommendations for extending and broadening economic progress included assuring sound government finance, improving private finance, promoting competition. increasing the opportunities for small business. strengthening the ties with other countries, developing natural resources, improving skills and technology, aiding areas hurt by persistent unemployment, improving health and housing standards. and strengthening personal security.

One of the important appendices presented a thorough analysis of population, its changes and prospects.

The summary of recommendations for economic legislation gives a good idea of the type of thinking at Federal government levels of that period. It is reproduced in part below (pp. 73–76):

SUMMARY OF RECOMMENDATIONS IN THE ECONOMIC REPORT OF THE PRESIDENT

Including Recommendations to the Congress and Suggestions to the States and Local Governments

I. Maintaining Sound Government Finances

a) Extend for a year beyond April 1, 1957 the present excise rates on automobiles and parts, cigarettes, distilled spirits. wines, and beer, and the present tax rate on the income of corporations.

V. Strengthening Economic Ties With Other Countries

a) Authorize United States membership in the Organization for Trade Cooperation.
b) Continue economic assistance, including defense support, under the Mutual Security Program.
c) Extend beyond June 30, 1958 the authority of the Export-Import Bank to approve credits.
d) Authorize full participation by the United States in the International Atomic Energy Agency.

VI. Enlarging Public Assets and Developing Natural Resources

a) Authorize partial Federal insurance against industrial atomic hazards.
b) Authorize a four-year program of Federal assistance for public school construction.
c) Authorize the Fryingpan-Arkansas project.
d) Take steps to resolve difficulties of State and local governments in accommodating metropolitan growth. (State and local responsibility)

See also Recommendations I (b) and (c).

VII. Improving Skills and Technology

See Recommendations VI (b) and XI (b).

VIII. Promoting Agricultural Adjustments

a) Extend Title I of the Agricultural Trade Development and Assistance Act for one year beyond June 30, 1957, and raise the present limit on permissible losses under this program by $1 billion.

IX. Aiding Local Areas of Persistent Unemployment

a) Establish an Area Assistance Administration in the Department of Commerce and enlarge the program of Federal aid to include loans and expanded technical assistance.

X. Improving Housing Standards

a) Amend the Servicemen's Readjustment Act to make the maximum interest rate on VA-guaranteed home loans conform to the current maximum applicable to FHA-insured home loans.
b) Amend the Housing Act of 1950 to relate the interest rate on Federal loans for college housing to market yields on long-term Government securities and provide for more frequent adjustments of the rate.
c) Increase the Treasury subscription to the capital stock of the Federal National Mortgage Association by $100 million, and approve additional authorizations for FNMA purchases under special assistance programs.
d) Consider changes in the home mortgage insurance program of the Federal Housing Administration to facilitate market adjustments inci-

dent to termination of home loan guarantee benefits for World War II veterans.

e) Extend the Voluntary Home Mortgage Credit Program beyond its scheduled expiration date of June 30, 1957.

f) Revise outmoded foreclosure laws, remove undue restrictions on mortgage lending by out-of-State institutions, and encourage the placement of pension and welfare funds in mortgage loans. (State responsibility)

XI. Raising Health Standards

a) Consider proposals for encouraging voluntary health insurance plans.

b) Authorize a temporary program of construction grants for medical and dental training facilities.

XII. Strengthening Personal Security

a) Raise maximum weekly unemployment insurance benefits and lengthen their maximum duration, where needed, and extend coverage to employees of the States and political subdivisions. (State responsibility)

b) Extend unemployment insurance to employees of firms with one to three persons on their payrolls, to ex-servicemen, and to employees in Puerto Rico.

c) Require Federal registration and filing of reports by private pension and welfare funds.

d) Extend minimum wage coverage to additional workers. (Federal and State responsibility)

e) Enact the principle of equal pay for equal work without discrimination on account of sex.

f) Authorize limited financial assistance to the States for promoting occupational safety.

g) Provide nonoccupational temporary disability insurance for employees in the District of Columbia. (Federal responsibility) Develop similar programs in the States. (State responsibility)

President Eisenhower's Economic Report of 1958

The 1958 Report was much like the earlier Eisenhower Reports in its emphasis on the private sector and the free enterprise system as the basis for economic growth. The letter of transmittal accompanying the Report stressed this philosophy in detail, as did the major portions of the document. A case was presented that argued the possibility of achieving the goals of growth and stability within the context of the free enterprise organization. Major shifts in the economy were described, with special attention being given to changes in aggregate demand, employment, income, prices, and production. Once more, a legislative program was recommended that embraced the major points of the Report. These proposals are summarized below (pp. 77–80):

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e) Extend the Voluntary Home Mortgage Credit Program beyond its scheduled expiration date of June 30, 1957.

f) Revise outmoded foreclosure laws, remove undue restrictions on mortgage lending by out-of-State institutions, and encourage the placement of pension and welfare funds in mortgage loans. (State responsibility)

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e) Enact the principle of equal pay for equal work without discrimination on account of sex.

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I. Government Finances

a) Extend the present tax rate on the income of corporations and the present excise rates on automobiles and parts, cigarettes, distilled spirits, wines, and beer for one year beyond July 1, 1958.
b) Enact legislation temporarily increasing the statutory debt limit.
See also Recommendation IV (a).

II. Federal Credit Programs

a) Grant wider discretionary authority to heads of Executive agencies and departments to set terms on private loans insured or guaranteed by the Federal Government.
b) Adjust interest rate limitations on certain FHA loan insurance programs (National Housing Act, Sections 207, 213, and 803) and on the VA Home Loan Guaranty Program.
c) Repeal the provisions of the Housing Act of 1957 requiring regulation of charges, fees, and discounts on federally insured or guaranteed home loans and the purchase of mortgages at par by the Federal National Mortgage Association under its special assistance programs.
d) Increase to $30,000 the maximum size of home mortgage loan that may be insured by the Federal Housing Administration under Sections 203 and 220 of the National Housing Act.
e) Increase the limit on outstanding insured loans of the Federal Housing Administration.

III. Science and Education

a) Provide funds on a temporary basis for grants to States to improve instruction and to strengthen State departments of education in the fields of science and mathematics, to identify and encourage able high school students, to provide college scholarships, and to improve State statistics on education; and funds for broader support of graduate education and the improvement and expansion of foreign language teaching in colleges and universities.
b) Authorize a temporary program of assistance for the expansion and modernization of medical and dental teaching facilities.

IV. Small Business and the Competitive System

a) Amend the tax laws to extend accelerated depreciation formulas to purchases of used property up to $50,000 in any one year; to permit closely held corporations the option of electing the tax status of partnerships; to grant taxpayers the option of paying estate taxes over periods of up to 10 years where estates largely consist of investments in closely held businesses; and to allow losses on original investments in the stock of small companies to be treated as ordinary loss deductions rather than capital loss deductions.
b) Permit the Securities and Exchange Commission to apply its simplified

notification procedure to security issues in amounts up to $500,000.

c) Remove the limitation on the life of the Small Business Administration and suitably increase its authorization for making business and disaster loans.
d) Require notification to the antitrust agencies of proposed mergers by businesses of significant size engaged in interstate commerce.
e) Extend Federal regulation to bank mergers accomplished through the acquisition of assets.
f) Empower the Attorney General in antitrust cases to issue civil investigative demands for the production of necessary documents without the need of grand jury proceedings.
g) Make Federal Trade Commission cease-and-desist orders issued for violations of the Clayton Act final, unless appealed to the courts.
h) Authorize the Federal Trade Commission to seek preliminary injunctions in merger cases where a violation may be likely.

V. Personal Welfare

a) Amount and duration of unemployment insurance benefits; coverage of firms with one to three persons on their payrolls; coverage of employees in Puerto Rico; coverage of State and local government employees. (State and Federal responsibility)
b) Bring the unemployment insurance provisions applicable to workers in the District of Columbia up to the standards recommended for the States.
c) Intensify efforts to develop and enforce adequate occupational safety standards and to encourage safe practices. (State and local responsibility)
d) Improve workmen's compensation laws with respect to benefits, administration, and provisions for rehabilitation. (State responsibility)
e) Authorize the Secretary of Labor to prescribe and enforce safety standards for longshoremen.
f) Provide nonoccupational temporary disability insurance for employees in States and Territorial jurisdictions where programs have not been established. (State and Federal responsibility)
g) Minimum wage legislation covering certain additional groups of workers; equal pay for equal work without discrimination on account of sex.
h) Improve the 8-hour laws applicable to Federal and federally assisted construction projects.
i) Establish an Area Assistance Administration in the Department of Commerce to extend loans, research grants and technical assistance in areas of persistent unemployment.
j) Require periodic public reports on the status of private employee welfare and pension funds, on financial dealings between employers and employee representatives or their agents, on general union finances, and on union organization and structure.

1958; amend certain customs administration provisions in the Tariff Act of 1930: and approve amendments to the Antidumping Act of 1921 to improve its administration.

c) Provide funds for the Development Loan Fund to finance economic development projects in underdeveloped countries, and for technical assistance under the United Nations program.

d) Increase the lending authority of the Export-Import Bank.

VIII. Federal Economic Statistics

a) Provide funds for the improvement of Federal economic statistics programs.

President Eisenhower's Economic Report of 1959

The 1959 Report reviewed the lessons learned from the experiences of the recession and recovery of 1957–58. The economy was described as possessing a unique ability to respond to and to resist recessions. Although policy implications vary according to the phase of the cycle, through it all the underlying objective was to achieve and to sustain vigorous economic growth.

Suggestions for policy were presented, with emphasis being placed on a balanced budget and growth, along with suggestions for price stability. A program for promoting economic growth without sacrificing price stability was described (pp. v–vi):

A Program for Economic Growth with Stable Prices

Our objective must be to establish a firm foundation for extending economic growth with stable prices into the months and years ahead. This will not come about automatically. To attain our goal, we must safeguard and improve the institutions of our free competitive economy. These are basic to America's unassailable economic strength. We must wage a relentless battle against impediments to the fullest and most effective use of our human and technological resources. We must provide incentives for the enlargement and improvement of the facilities that supplement human effort and make it increasingly productive. Finally, an indispensable condition for achieving vigorous and continuing economic growth is firm confidence that the value of the dollar will be reasonably stable in the years ahead.

Action to meet these challenges is required on many fronts, by all groups in our society and by all units of government.

The individual consumer can play an important part by shopping carefully for price and quality. In this way the American housekeeper can be a powerful force in holding down the cost of living and strengthening the principle that good values and good prices make good business.

Businessmen must redouble their efforts. They must wage a ceaseless

war against costs. Production must be on the most economical basis possible. The importance of wide and growing markets must be borne in mind in setting prices. Expanding markets, in themselves, promise economies that help keep costs and prices in check.

Leaders of labor unions have a particularly critical role to play, in view of the great power lodged in their hands. Their economic actions must reflect awareness that the only road to greater material well-being for the Nation lies in the fullest realization of our productivity potential and that stability of prices is an essential condition of sustainable economic growth.

The terms of agreements reached between labor and management in wage and related matters will have a critical bearing on our success in attaining a high level of economic growth with stable prices. It is not the function of Government in our society to establish the terms of these contracts, but it must be recognized that the public has a vital interest in them. Increases in money wages and other compensation not justified by the productivity performance of the economy are inevitably inflationary. They impose severe hardships on those whose incomes are not enlarged. They jeopardize the capacity of the economy to create jobs for the expanding labor force. They endanger present jobs by limiting markets at home and impairing our capacity to compete in markets abroad. In short, they are, in the end, self-defeating.

Self-discipline and restraint are essential if reasonable stability of prices is to be reached within the framework of the free competitive institutions on which we rely heavily for the improvement of our material welfare. If the resired results cannot be achieved under our arrangements for determining wages and prices, the alternatives are either inflation, which would damage our economy and work hardships on millions of Americans, or controls, which are alien to our traditional way of life and which would be an obstacle to the Nation's economic growth and improvement.

The chief way for Government to discharge its responsibility in helping to achieve economic growth with price stability is through the prudent conduct of its own financial affairs. The budget submitted to the Congress for the fiscal year 1960, which balances expenditures with receipts at a level of $77 billion, seeks to fulfill this responsibility. If Government spending is held within the limits set in the proposed budget, the growth of our economy at the rate that may be expected would make it possible in the reasonably foreseeable future to provide, through a significant further step in tax reform and reduction, added incentives and means for vigorous economic growth and improvement.

Governmental actions in other areas can also help to maintain price stability as our economy expands. The Congress will be requested to amend the Employment Act of 1946 to make reasonable price stability an explicit goal of Federal economic policy, coordinate with the goals of maximum production, employment, and purchasing power now specified in that Act. Steps will be taken within the Executive Branch to assure

that governmental programs and activities are administered in line with the objective of reasonable price stability, and programs for the enlargement and improvement of public information on prices, wages and related costs, and productivity will be accelerated.

The many continuing programs of Government that promote the expansion and improvement of our economy will be administered vigorously. . . .

PART THREE

* * *

The Development of Major Policy Issues as Seen in the Economic Reports from 1960 to 1967

4. GOALS OF NATIONAL ECONOMIC POLICY

ONE OF THE significant features of the President's Economic Reports has been to outline goals for national economic policy. As these reports are reviewed, it is possible to discern in retrospect how these goals come to influence subsequent legislative recommendations and the direction of policy. It is also possible to view the delineation of goals in terms of the general political and economic beliefs of the party in power. Nonetheless, the statements of goals do have a common thread of growth, stability, and increased consumption. In terms of these goals, the reports also give clear statements of the challenges that face the nation and of the unfinished tasks that remain.

It is interesting to observe that there was little change in the statement of goals as the Democratic Party succeeded the Republicans in 1961. What did change, however, was the greater emphasis given to the role of the Federal government and the lesser role to the private sector. Aside from this difference, the overall statements of goals have much in common.

President Kennedy's Economic Report of 1961

Since many of the current goals of national economic policy take their cue from the Employment Act, the 1961 Report submitted by President John F. Kennedy reviewed the varied responsibilities under that legislation, with special attention being given to the problems of coordinating the apparent conflicts between these objectives (pp. 45–47).

The Report also argued that the goals of growth and improved living standards depend primarily on the behavior of the private sector (p. 57).

BACKGROUND AND MEANING OF THE EMPLOYMENT ACT

From its beginning, the United States economy has been organized on the basis of maximum opportunity for private competitive enterprise and the widest possible latitude for personal choice in making a living and spending one's income. Any narrowing of the horizons for individual

initiative is alien to the nature of our enterprise system; and when controls and unusual restrictions on personal action have had to be introduced during an emergency, their abandonment at the end of the temporary period of crisis has been awaited impatiently.

In this tradition, the action approached cautiously the problem of Federal intervention respecting employment and the maintenance of economic activity generally. Appeals for such intervention were resisted, for example, during the sharp economic downturn in 1921, when occasional depressions were still regarded as inevitable and the belief that they could be significantly moderated through governmental action had not taken hold. But a step taken that year was important for later developments: the President's Conference on Unemployment was established to make studies that would increase understanding of the operation of our economy and thus help to avoid the recurrence of widespread joblessness. The work of this Conference, which made its final report only shortly before the Great Depression began, was reflected in the Employment Stabilization Act of 1931, which sought to provide for "advance planning and regulated construction of public works, for the stabilization of industry, and for aiding in the prevention of unemployment during periods of business depression."

Despite a series of countermeasures, the heavy unemployment of the 1930's persisted until the tremendous increase in production required in World War II and the service of 11½ million persons in the Armed Forces reduced it to a minimum and created even a degree of overemployment. With the turn in the tide of war, however, memory of deep depression in the 1930's and the expected demobilization of the Armed Forces heightened concern for the Nation's economic future and aroused a keen interest in measures to help avoid the widespread unemployment that it was feared would result from demobilization and reduced spending on arms.

It was in this atmosphere of concern that the Congress turned its attention to legislative measures to cope with unemployment, should it emerge as a serious postwar problem. Congressional staff committees made comprehensive studies of the incidence and duration of unemployment and of possible methods for dealing with it. Extensive hearings were held, and a bill, the Full Employment Act of 1945, was introduced in Congress, providing for a considerably broader attack on unemployment than the public works program envisioned in the Employment Stabilization Act of 1931. The bill failed of enactment, but subsequently a revised version, the Employment Act of 1946, was passed overwhelmingly with bipartisan support in both houses of the Congress.

At the time it was approved, the Employment Act represented a major extension of our traditional concept of shared private and public responsibility for the Nation's economic growth and improvement. It gave explicit expression to a continuing interest on the part of the Federal Government in aspects of economic life that, outside the sphere of mone-

tary policy, had previously received deliberate Federal attention only in such emergency conditions as depression and war.

It is useful to recall the language of the Act's declaration of policy: "The Congress declares that it is the continuing policy and responsibility of the Federal Government to use all practicable means consistent with its needs and obligations and other essential considerations of national policy, with the assistance and cooperation of industry, agriculture, labor, and State and local governments, to coordinate and utilize all its plans, functions, and resources for the purpose of creating and maintaining, in a manner calculated to foster and promote free competitive enterprise and the general welfare, conditions under which there will be afforded useful employment opportunities, including self-employment, for those able, willing, and seeking to work, and to promote maximum employment, production, and purchasing power."

Thus, the Employment Act states that it shall be the policy of the Federal Government to promote conditions under which there will be afforded employment opportunities by methods that are consistent with the traditional American philosophy of individual freedom and competitive enterprise. Although the Act enlarges the area of explicit Federal concern to include the quality of our current and expected economic accomplishment, it does so without diminishing the scope of private, State, and local responsibility. Far from seeking to centralize economic decision-making in the Federal Government, or even to confer predominant responsibility for economic growth and improvement on the Federal Government, the law explicitly acknowledges the multiple sources of economic strength in private individuals and groups and at the several levels of government. The theme of the Act is captured in a phrase used in the Economic Report of 1960 and in the present one: "shared responsibility for economic growth and improvement." This principle, manifest in our economic life as in other aspects of the American way, has carried us to the highest material wellbeing ever achieved, without hobbling the human spirit and without impairing our political freedoms.

The framers of the Act proposed high standards of economic achievement. They wisely omitted, however, any requirement that economic goals be publicly stated as fixed quantitative targets, although this fact gives no ground for indifference to failure to attain the best levels of production, employment, and income that are feasible and sustainable for any period. Such a requirement could invite broad, irreversible intervention by the Federal Government if the projected targets were not reached. The Act instead contemplates a framework in which the mainsprings of private individual initiative continue to function in behalf of brisk economic activity, and in which the individual retains a wide freedom of choice. In our economic system, the level of achievement is everyone's responsibility and cannot be guaranteed by the Federal Government acting alone.

It should be noted, also, that the Act states that the Nation's economic

objectives should be pursued with due regard to other Federal objectives and obligations, which must include a stable currency and protection of the value of the dollar. The goals of economic policy, furthermore, are not ranked. They have to be pursued coordinately; emphasis on one to the neglect of others would soon prove self-defeating. . . .

GOVERNMENT AND PRIVATE POLICIES

In our free economy, economic growth and the improvement of living standards depend not primarily on what government does but mainly on what is done by individuals and groups acting in their private capacities. In this system of shared responsibility, the tempo of economic activity is especially sensitive, for example, to the plans and actions of large firms and powerful labor organizations whose operations are national and international in scope.

Government makes its basic economic contribution not through the volume of its own expenditures but by promoting conditions favorable to the exercise of individual initiative and private effort. Accordingly, a dominant purpose of government at every level must be the preservation and invigoration of institutions that favor and support enterprise. In particular, the Federal Government should encroach no more than necessary on the province of private action. Indeed, it should expand as broadly as possible the opportunities for private decision-making; strengthen incentives for businessmen, workers, savers, and investors; and promote a vigorously competitive environment in domestic and international markets. And within the area of public action, the Federal Government must avoid encroachment on the province of State and local units. The expected increase in the demand for public investment and the emergence of new regional and area problems will require efforts on the part of State and local authorities and of citizens in general to render more effective the instruments of government located close to home. A proper sharing of governmental responsibility may require a strengthening of the capacity of State and local entities to meet their emerging and increasingly heavy burdens.

President Kennedy's Economic Report of 1962

The 1962 Report of the President was specific in outlining a series of national economic goals emphasizing full and sustained prosperity, and without inflation, as follows (pp. 7–10):

> . . . The unfinished business of economic policy includes (1) the achievement of full employment and sustained prosperity without inflation, (2) the acceleration of economic growth, (3) the extension of equality of opportunity, and (4) the restoration of balance of payments equilibrium. Economic policy thus confronts a demanding assignment, but one which can and will be met within the framework of a free economy.

bilities during the 1960's. It will lay the groundwork for meeting both our domestic needs and our world responsibilities.

In November of last year we joined with our 19 fellow members of the Organization for Economic Cooperation and Development in setting a common target for economic growth. Together we pledged ourselves to adopt national and international policies aimed at increasing the combined output of the Atlantic Community by 50 percent between 1960 and 1970. The nations of the West are encouraged and enlivened by America's determination to make its full contribution to this joint effort.

We can do our share. In the mid-1960's, the children born in 1943 and after will be arriving at working age. The resulting rapid growth in our labor force offers us an opportunity, not a burden—provided that we deliver not only the jobs but also the research, the training, and the capital investment to endow our new workers with high and rising productivity as they enter economic life.

Our Goal of Equal Opportunity

Increasingly in our lifetime, American prosperity has been widely shared and it must continue so. The spread of primary, secondary, and higher education, the wider availability of medical services, and the improved postwar performance of our economy have bettered the economic status of the poorest families and individuals.

But prosperity has not wiped out poverty. In 1960, 7 million families and individuals had personal incomes lower than $2,000. In part, our failure to overcome poverty is a consequence of our failure to operate the economy at potential. The incidence of unemployment is always uneven, and increases in unemployment tend to inflict the greatest income loss on those least able to afford it. But there is a claim on our conscience from others, whose poverty is barely touched by cyclical improvements in general economic activity. To an increasing extent, the poorest families in America are those headed by women, the elderly, nonwhites, migratory workers, and the physically or mentally handicapped—people who are shortchanged even in time of prosperity.

Last year's increase in the minimum wage is evidence of our concern for the welfare of our low-income fellow citizens. Other legislative proposals now pending will be particularly effective in improving the lot of the least fortunate. These include (1) health insurance for the aged, financed through the social security system, (2) Federal aid for training and retraining our unemployed and underemployed workers, (3) the permanent strengthening of our unemployment compensation system, and (4) substantial revision in our public welfare and assistance program, stressing rehabilitation services which help to restore families to independence. . . .

President Johnson's Economic Report of 1965

In the 1965 Report, President Lyndon B. Johnson reviewed the nation's goals and indicated how national policy had been evolved to meet these challenging objectives (pp. 20–21).

> In our economic affairs, as in every other aspect of our lives, ceaseless change is the one constant.
>
> Revolutionary changes in technology, in forms of economic organization, in commercial relations with our neighbors, in the structure and education of our labor force converge in our markets. Free choices in free markets—as always—accommodate these tides of change.
>
> But the adjustments are sometimes slow or imperfect. And our standards for the performance of our economy are continually on the rise. No longer will we tolerate widespread involuntary idleness, unnecessary human hardship and misery, the impoverishment of whole areas, the spoiling of our natural heritage, the human and physical ugliness of our cities, the ravages of the business cycle, or the arbitrary redistribution of purchasing power through inflation.
>
> But as our standards for the performance of our economy have risen, so has our ability to cope with our economic problems.
>
> Economic policy has begun to liberate itself from the preconceptions of an earlier day, and from the bitterness of class or partisan division that beclouded rational discussion and hamper rational action.
>
> Our tools of economic policy are much better tools than existed a generation ago. We are able to proceed with much greater confidence and flexibility in seeking effective answers to the changing problems of our changing economy.
>
> The accomplishments of the past four years are a measure of the constructive response that can be expected from workers, consumers, investors, managers, farmers, and merchants to effective public policies that strive to define and achieve the national interest in
>
> —full employment with stable prices;
> —rapid economic growth;
> —balance in our external relationships;
> —maximum efficiency in our public and private economies.
>
> These perennial challenges to economic policy are not fully mastered; but we are well on our way to their solution.
>
> As increasingly we do master them, economic policy can more than ever become the servant of our quest to make American society not only prosperous but progressive, not only affluent but humane, offering not only higher incomes but wider opportunities, its people enjoying not only full employment but fuller lives. . . .

Report of the Council of Economic Advisors, 1965

In its accompanying Report, the Council continued this same approach and presented a clear statement describing how national economic goals are developed (pp. 32–33).

We seek a world in which men, women, and children are healthy in mind and body. Economists cannot cure the illnesses of man. But they can devise ways to support hospitals, treatment centers, medical research, and the spread of the latest knowledge.

Our goal is a free society, where men and women control their own destinies, where they decide for themselves where and how to spend their lives, their incomes, their time—free from governmental or private coercion. We seek to make opportunities equally open to all. Economic policy can enlarge freedom by breaking down artificial barriers to mobility and choice, by expanding the flexibility and responsiveness of production to changing wants, by encouraging diversity, and by preserving and increasing the rewards to originality and enterprise.

Relating economic policy to broader human goals is not an altogether new orientation for the Council. Three years ago, it began its Annual Report with these words:

> The Report of the Council of Economic Advisers is a document directed toward economic problems and national economic policy. It is written in keen awareness that the ultimate goals of the Nation are human goals, and that economics is merely instrumental to the making of a better life for all Americans. Involuntary unemployment is a sign of economic waste, but the fundamental evil of unemployment is that it is an affront to human dignity. Expenditures on better education and better health are investments in future capacity to produce; but even if they were not, they would be intrinsically desirable because ignorance and illness bar the way to happiness and security for many of our citizens. Social security and welfare benefits help to limit the depth of recessions, but their more important function is to protect human beings from hunger and despair. Statistical tables are to the economist what test tube and microscope are to the scientist —the tools of the trade; but for the one as for the other, the ultimate dedication is to the quality of human life.

Under the Employment Act, the basic duty of the Council of Economic Advisers is to advise the President on measures to achieve the goals of "maximum employment, production, and purchasing power." If the economy performs well by the standards of the Act, the general climate will be hospitable to the many specific activities, public and private, which will advance our human goals.

In 1964, the United States passed a watershed in economic policy. After lengthy debate, this country boldly reduced taxes to accelerate expansion and reduce unemployment. The effects were immediate and telling. A mild expansion—which might soon have lapsed into tired decline—

picked up its pace, and at year end showed every sign of long and vigorous life.

The lessons of 1964 will not soon be lost:

—Fiscal policy can sustain growth and raise spending power to the levels needed to use our resources more fully.

—Price stability can be maintained during a strong and balanced expansion.

—The balance of payments can improve in a period of prosperity.

A new era for economic policy is at hand. A wide consensus of responsible opinion now recognizes that Federal fiscal policy must be geared to keep the economy moving ahead.

President Johnson's Economic Report of 1966

The 1966 Report of President Johnson (pp. 5–6) outlines clearly how the national government views its responsibilities in helping to achieve the objectives of public economic policy.

THE PRINCIPLES OF ECONOMIC POLICY

In a time of high prosperity, economic policy faces new problems. But it is still guided by the basic principles that have served us so well.

Twenty years ago next month, the Employment Act of 1946—which prescribes this Report—became law. The principles of our policy emerge from that Act and from our two decades of experience under it.

The essential and revolutionary declaration of the Employment Act was that the Federal Government must accept a share of responsibility for the performance of the American economy. The nature of that share has been more and more clearly defined over the years, by the recommendations of four Presidents and the enactments of ten Congresses.

I see these as the main tasks of Federal economic policy today:

1. To attain full employment without inflation; to use fiscal and monetary policies to help to match total demand to our growing productive potential, while helping to speed the growth of that potential through education, research and development, manpower policies, and enlarged private and public investment;

2. To help to open the doors of opportunity to all, through developing human resources and removing barriers of discrimination, ignorance, and ill-health;

3. To help to solve social and economic problems that neither private action nor State and local governments can solve alone—an efficient transportation system, the protection of our environment, the health of our agriculture, the reconstruction of our cities;

4. To achieve and maintain equilibrium in the Nation's external payments, and to press for improvements in the international economic order;

5. To maintain and enhance healthy competition;

6. To achieve national purposes as far as possible by enlisting the voluntary cooperation of business, labor, and other groups.

Recognition of these responsibilities of the Federal Government neither lessens the responsibilities nor impairs the freedoms of individuals and private groups; nor does it challenge the authority of State and local governments.

The tasks involve new and growing problems of an increasingly complex and interdependent economy and society. Only the Federal Government can assume these tasks. But the Federal Government by itself cannot create prosperity, reduce unemployment, avoid inflation, balance our external accounts, restore our cities, strengthen agriculture, eliminate poverty, or make people healthy.

Only through a creative and cooperative partnership of all private interests and all levels of government—a creative Federalism—can our economic and social objectives be attained. This partnership has written the story of American success. And a new vitalization of this partnership and a new confidence in its effectiveness have produced the extraordinary economic and social gains of recent years. . . .

President Johnson's Economic Report of 1967

Instead of outlining goals specifically, the 1967 Report of President Johnson implies these goals as it reviews the gains of recent years (pp. 3–4). The Report then goes on to describe a number of economic problems and suggests policies for their solution. In effect, these become the goals, such as more equitable distribution of the gains of national economic progress, greater price stability, achieving equilibrium in the balance of payments, and assisting the disadvantaged through a number of welfare programs.

RECENT ECONOMIC GAINS

An average of 74 million persons were at work in 1966—2 million more than in 1965. Nonfarm payrolls averaged 64 million, a gain of 3 million. On the whole, these jobs were better paying than ever, and more regular and more secure than most workers can remember.

The value of our total production of goods and services in 1966 was \$740 billion—\$58 billion, or 8½ percent, higher than in 1965. More of the increase than we wanted represented higher prices. Still, the gain was nearly 5½ percent *after* correction for price changes.

Labor, business, and the farmer all contributed to this major gain in production, and they rightly shared the benefits.

Aggregate compensation of employees rose 10.3 percent. Average compensation per man-hour in the private economy rose 6.5 percent, reflecting increased wages and fringe benefits, more overtime, the shift to higher-paying jobs, and increased employer contributions to Social Se-

curity. Corporate profits after taxes advanced more than 8 percent; per dollar of sales they were roughly unchanged from the high rate of 1965. Net income per farm rose more than 10 percent.

The single most meaningful measure of economic well-being is real disposable income person—the after-tax purchasing power in stable dollars, available on the average to every man, woman, and child. It rose 3½ percent or $89 per person in 1966. Although this advance was somewhat smaller than in 1965, it was still three times as large as the average yearly gain in the 1950's.

February 1961 launched the strongest and most durable economic expansion in our economic annals, and it still continues.

- Almost 9 million jobs have been added in the last 6 years.
- The rate of unemployment has fallen from 7 percent in early 1961 to under 4 percent. The rate for white adult males fell from 5 percent to 2 percent; for Negro men, from nearly 12 percent to less than 5 percent.
- Early in 1961, more than two-thirds of our major labor markets were "areas of substantial unemployment"; today only 8 of the 150 are so classified, and 66 have unemployment below 3 percent.
- While total population rose 11 million between 1961 and 1965, the number of Americans in poverty declined 5½ million, and probably fell at least another 1¼ million in 1966. (The poverty definition is adjusted for the increase in living costs.)
- Our gross national product (GNP) has grown 50 percent in 6 years. In constant prices, the gain has averaged 5½ percent a year. The physical output of our factories and mines is up over 50 percent.
- Private output per man-hour in 1966 was 19 percent higher than in 1961.
- The 6-year addition to our gross stock of private productive capital—machines, buildings, transportation equipment, land improvements, and inventories—is valued at $220 billion.
- American families have added $470 billion to their accumulated financial assets. They have added $150 billion to their debts. So their net financial position is $320 billion stronger than 6 years ago. . . .

The partial conflict which exists between minimum unemployment and certain other national objectives—and which imposes the necessity of striking a balance between them—results mainly from the fact that these other objectives are served by stability of the general price level. Given the existing structure of the economy and the nature of the processes by which prices and wages are determined, a serious attempt to push unemployment close to zero would produce a high rate of price inflation. The result would be a weakening of the competitive position of U.S. products in world markets, an arbitrary redistribution of real income and wealth, and a threat of even more serious consequences if expectations of further inflation should become dominant.

Happily, however, the conflict between the goals served by price stability and the goal of minimum unemployment is only partial. Stabilization policy—policy to influence the level of aggregate demand—can strike a balance between them which largely avoids the consequences of a failure in either direction. Furthermore, the degree of conflict can be diminished by private and public policies which improve the functioning of labor and product markets.

There are various possible causes of unemployment, on the one hand, and of inflationary pressure, on the other. These causes may be grouped into (1) those related to aggregate demand and (2) those related to the structure and functioning of markets. It is necessary to distinguish carefully between these two groups of causes in setting an appropriate target for stabilization policy.

The relation of aggregate demand and of structural causes to unemployment may be briefly described as follows:

(1) The total effective demand for goods and services—by consumers, businesses, and governments—may be insufficient to employ all the persons seeking work at existing wage rates.

(2) Workers may be idle while vacancies are unfilled. This may arise because the workers live too far away from the available jobs, are not qualified for them, or simply are unaware of their existence. In a dynamic economy, there will always be workers between jobs, some seeking new positions out of preference, some displaced by economic and technological change. New entrants to the labor force will similarly be unemployed while locating jobs suitable to their qualifications and preferences. The length of "frictional" unemployment for any one worker, and the size of the pool of frictionally unemployed, depend on how smoothly the labor market functions, how well the skills, experience, and qualifications of workers match the specifications of available jobs, how ready workers are to change residence and occupation, how adequate are facilities for training and retraining, and how rapidly displacements resulting from economic change are occurring. Structural unemployment may be regarded as an extreme form of frictional unemployment. It occurs when inability or failure to make the necessary adjustments concentrates unemployment of long duration on displaced workers in particular areas

to find an attractive job is reduced. When there are vacancies everywhere, no one needs to travel far to find a job. And when no applicant for a job meets its exact specifications, the specifications may well be adjusted. Similarly, the degree of inflationary pressure arising from discretionary price and wage setting is not independent of the general strength of demand. Presumably, this pressure could be entirely eliminated by sufficient weakness in aggregate demand if that were the sole objective of stabilization policy.

But while stabilization policy would not be an ineffective cure for either one or the other of these economic ailments, it would be an extremely expensive cure. On the one hand, attempting to reduce frictional and structural unemployment by a highly inflationary expansion of demand would court disaster in our balance of payments position. On the other hand, an attempt to restrict aggregate demand so severely as to eliminate all risk of an increase in the general price level might well involve keeping the economy far below full employment. This would mean sacrifice rather than achievement of both of the major goals that price stability serves. . . .

Economic Stabilization

Insufficient demand means unemployment, idle capacity, and lost production. Excessive demand means inflation—general increases in prices and money incomes, bringing forth little or no gains in output and real income. The objective of stabilization policies is to minimize these deviations, i.e., to keep over-all demand in step with the basic production potential of the economy.

Stabilization does not mean a mere leveling off of peaks and troughs in production and employment. It does not mean trying to hold over-all demand for goods and services stable. It means minimizing deviations from a rising trend, not from an unchanging average. In a growing economy, demand must grow in order to maintain full employment of labor and full utilization of capacity at stable prices. The economy is not performing satisfactorily unless it is almost continuously setting new records of production, income, and employment. Indeed, unless production grows as fast as its potential, unemployment and idle capacity will also grow. And when the economy starts from a position well below potential, output must for a time grow even faster than potential to achieve full utilization.

The Postwar Record

Despite the recessions of recent years and the inflationary excesses of the early postwar years, the postwar record of economic stabilization is incomparably better than the prewar. The economy fluctuated violently in 1919–21 and operated disastrously far below potential from 1930 to 1942. The 1929 level of GNP, in constant prices, was not exceeded, except briefly in 1937, until 1939. The difference between the 17 percent

unemployment of 1939 and the 3 percent rate 10 years earlier is a dramatic measure of the growth of the labor force and productivity even during depression. Since the war, the economy's detours from the path of full employment growth have been shorter in both time and distance. There have been four recessions, but none of them has gotten out of hand, as did the decline of 1929–33. All of the declines have been reversed within 13 months, before unemployment reached 8 percent of the labor force. For this improved performance there are several reasons.

First, the war and preceding depression left business firms and households starved for goods. Further, wartime earnings coupled with scarcities of civilian goods, rationing, and price control, saturated business firms and consumers with liquid assets. For these legacies of depression and war, the economy paid a price in the inflations of 1946–48 and 1950, with delayed effects throughout the past decade.

Second, the structure of the economy was reformed after 1933 in ways which substantially increased its resistance to economic fluctuations. The manner in which government tax revenues and income maintenance programs serve as automatic or "built-in" economic stabilizers is described below. The New Deal strengthened and reformed the Nation's banking and financial system with the help of new governmental credit institutions, deposit insurance, and loan and guarantee programs. These have virtually eliminated the possibility that economic declines will be aggravated by bank failures, foreclosures, and epidemic illiquidity.

Third, there is a significantly improved understanding of the manner in which government fiscal and monetary tools can be used to promote economic stability. Under the Employment Act and the climate of opinion which it symbolizes, the Government has been expected to assume, and has assumed, greater responsibility for economic stabilization.

Finally, businessmen and consumers no longer regard prolonged and deep depression as a serious possibility. They generally expect recessions to end quickly; they anticipate a long-term upward trend in the economy; and they spend and invest accordingly. This stability of expectations is in part the result of stability achieved in fact, and reflects general understanding of the structural changes which have contributed to it. But expectations of stability are also a cause of stability—nothing succeeds like success.

Achieving Greater Stability

While our postwar performance is a great advance over that of prewar years, it is still far from satisfactory. We have had no great depression, but we have had four recessions. Even the relatively short and mild recessions of the postwar period have been costly. In the last decade, the Nation has lost an estimated $175 billion of GNP (in 1961 prices) by operating the economy below potential. Industrial production has been below its previous peak nearly half the time since 1946.

There is general agreement that economic fluctuations in the United

tax rates unchanged—have expansionary effects on the economy. Whether an expansion in spending—government or private—leads mainly to more output or mainly to higher prices depends on the degree of slack in the economy. Under conditions of widespread unemployment and excess capacity, businessmen respond to higher demand by increasing production; under conditions of full employment, prices rise instead. In the slack economy of 1961, for example, additional demand from both private and public sources was readily converted into increased production.

Built into the Federal fiscal system are several automatic defenses against recession and inflation. Given the tax rates, tax revenues move up and down with economic activity, since most taxes are levied on private incomes or sales. Indeed, tax revenues change proportionally more than GNP. Furthermore, certain Federal expenditures, such as unemployment compensation payments, are automatically affected by the state of the economy. Economic fluctuations, therefore, result in substantial changes in Federal expenditures and revenues, even when basic expenditure programs and tax rates remain unchanged. With the present system of tax rates and unemployment compensation payments, a one-dollar reduction in GNP means a reduction in Federal tax receipts and an increase in transfer payments totaling about 30 cents. Therefore, private incomes after Federal taxes fall by only 70 cents for each reduction of one dollar in GNP. For this reason, any initial decline in spending and output is transmitted with diminished force to other sectors of the economy.

These automatic or built-in stabilizers moderate the severity of cyclical swings in the economy. If the forces causing a downturn in economic activity are weak and transient, the automatic stabilizers cushion the severity of the decline and give the basic recuperative powers in the private economy a better opportunity to produce a prompt and full recovery.

But if the forces causing the downturn are strong and persistent, the built-in stabilizers may not suffice to prevent a large and prolonged recession. Furthermore, they are blindly symmetrical in their effects. When economic activity quickens after a slump, the rise in Federal revenues begins immediately and slows the recovery in employment and incomes. For these reasons, the task of economic stabilization cannot be left entirely to built-in stabilizers. Discretionary budget policy, e.g., changes in tax rates or expenditure programs, is indispensable—sometimes to reinforce, sometimes to offset, the effects of the stabilizers.

To be effective, discretionary budget policy should be flexible. In order to promote economic stability, the Government should be able to change quickly tax rates or expenditure programs, and equally able to reverse its actions as circumstances change. Failure to arrest quickly a downturn in income, production, and employment may shake the faith of firms and households in prompt recovery and thereby lead to a cumulative decline. Delay in countering inflationary pressures may permit the

full-employment budget is too large when the Government demand contained in the budget, and private investment and consumption demands forthcoming from after-tax incomes, are insufficient to bring total output to the full-employment level. The actual budget will then show a smaller surplus or larger deficit than the full-employment budget.

If the fiscal structure is biased in this direction, it can be corrected either by expanding Government purchases to employ idle resources in satisfying public needs; or by expanding private business and personal after-tax incomes through reduced tax rates or increased transfer payments to employ idle resources in satisfying the demands of the private sector. When the budget is too expansionary, the combination of public and private demands will eventually exceed productive capacity, and excessive upward pressure on prices will develop. In this event, sound fiscal policy calls for lowering expenditures or raising tax rates, or both.

The appropriate size of the surplus or deficit in the full-employment budget depends on the strength of private demand and its responsiveness to fiscal policy. The budget must counterbalance private demand. The weaker the underlying determinants of private demand, the more expansionary the budget should be; the stronger these determinants, the more restraining the budget should be.

Whether a given budget is too expansionary or restrictive depends also on other Government policies affecting private spending, of which monetary policy is the most important. Other things being equal, a strongly expansionary monetary policy permits a larger surplus by strengthening business investment, residential construction, and other expenditures that are sensitive to the cost and availability of credit.

Views of President Johnson, Economic Report of 1966

The 1966 Economic Report of the President details how successful the economy has been in achieving the goals we have described, especially those relating to full employment. Attention is called to the fact that the recent growth in Gross National Product has been sustained and balanced among the various components of GNP, to the importance of both consumption and investment as source of economic strength, to the nearer approximation of actual to potential output as fuller utilization of resources has been realized, and to the closer balance between investment and saving (pp. 31–42).

APPROACHING FULL EMPLOYMENT

The American Economy took a giant step in 1965 toward the achievement of the Employment Act's goals of "maximum employment, production, and purchasing power." It was the fifth year of uninterrupted economic expansion, and the second year of declining unemployment as output moved closer to the economy's growing productive potential.

Since the Revenue Act of 1964 became effective, the economy has shown new vigor. Living standards have risen at an unprecedented rate, and businessmen have found new and stronger incentives to expand and modernize their productive facilities. Employment has forged ahead dramatically, enlarging job opportunities, particularly for the young and the less advantaged groups in the labor force. As the year closed, the unemployment rate was 4.1 percent, within inches of the 4 percent interim goal set by the Kennedy Administration in the 1962 Economic Report and below any rate achieved since the mid-1950's. Meanwhile, despite some pressures on prices for particular commodities, the over-all price record remained far better than in that earlier period. In addition, last year witnessed significant progress toward equilibrium in the balance of payments.

Today, our vigorous economy is in a strong position to carry the new burdens imposed by expanded national defense requirements. With another large advance in total production ahead, defense needs will be met while consumer living standards again improve strongly and the capital stock is further enlarged. Indeed the *increase* in output available for civilian uses this year is expected to be one of the largest in our history.

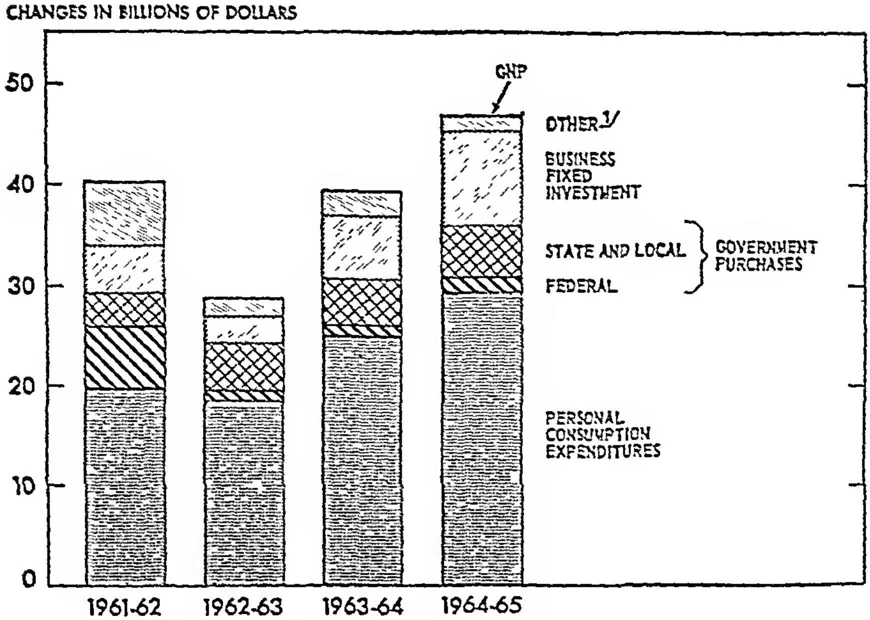
National security, of course, has first priority on the budget and the first claim on production. It certainly represents a less welcome use of our national output than would Federal civilian programs or the private spending that would come from tax reduction. Progress will continue in building the Great Society, but the pace of Federal civilian programs reflects the current urgency of national defense.

Furthermore, rising defense requirements clearly complicate the task of economic policy. The stimulative fiscal policies of recent years have achieved their mission. Consumer spending and investment demand have both been invigorated. The same logic that called for fiscal stimuli when demand was weak now argues for a degree of restraint to assure that the pace of the economy remains within safe speed limits. Measures to moderate the growth of private purchasing power are needed to offset, in part, the expansionary influence of rising defense outlays if intensified price and wage pressures are to be avoided. A combination of such measures—affecting excise tax rates and the timing of individual and corporate tax payments—is thus a key proposal in the President's fiscal program.

At the same time, the Administration looks toward further declines in unemployment during the year ahead—indeed, to the lowest level since 1953. These ambitious targets are a renewed expression of confidence in the vigor, adaptability, and productivity of our private economic system—a confidence which has been richly reaffirmed and rewarded in the past 2 years by the Nation's smooth progress and efficient performance in approaching full employment. Nonetheless, this is a year of many uncertainties: the advance into the new territory of still lower unemployment must be made with care; meanwhile, defense requirements could shift suddenly in either direction in the months ahead. Fiscal policy stands

Chart 1

Changes in Gross National Product Since 1961



1/ RESIDENTIAL STRUCTURES, CHANGE IN BUSINESS INVENTORIES, AND NET EXPORTS OF GOODS AND SERVICES.
SOURCE: DEPARTMENT OF COMMERCE.

Kennedy Administration was convinced that adequate total demand could reduce unemployment at least to 4 percent without inflation. To accomplish this objective, it developed a comprehensive program of tax measures, including lower personal and corporate tax rates, depreciation reform, and an investment tax credit. The personal tax cuts raised after-tax earnings and spurred more spending by consumers. The corporate measures added further to private investment incentives and to the volume of investible funds.

The economy responded well to these measures, and especially to the major tax cut of February 1964. GNP rose by nearly $40 billion in 1964, compared with the gain of almost $30 billion in 1963, and the unemployment rate fell to 5.0 percent by the end of the year.

Statistical analysis of the impact of the tax reduction suggests that it was responsible for nearly the entire $10 billion step-up in the annual increase of GNP. The reduction in tax liabilities in 1964 boosted the after-tax incomes of households and businesses. Spending by these sectors, particularly consumer outlays, rose in response to these larger after-tax incomes. This higher spending increased sales, employment, and earnings. Larger earnings, in turn, provided the basis for still more consumption spending. Investment was also stimulated by gains in business sales and higher capacity utilization. By early 1965, the contribution of the tax cut in lifting consumption and investment spending was more than $20

billion (annual rate). Since the effects of the tax cut cumulate through time, its contribution has grown further, reaching \$30 billion by the end of 1965.

As 1965 opened, the remaining lift from the Revenue Act of 1964 was not in itself sufficient to assure a sustained reduction in unemployment. Consequently, a good opportunity was presented for a long-awaited reduction in excise taxes and a liberalization of Social Security benefits, both of which were desirable on equity grounds. These actions were proposed in the fiscal 1966 budget, presented in January 1965. In combination with expected modest increases in other expenditures, they more than offset the normal growth of Federal revenues, and thus provided a net fiscal stimulus for calendar 1965. The stimulus was planned for the second half of the year since heavy stocking of steel inventories in anticipation of a strike was expected to stimulate demand early in the year and subsequently to be reversed.

The fiscal actions in 1965 were a success. The economy did move further toward full employment, even more rapidly than anticipated; yet demand did not outstrip capacity to produce.

SOURCES OF STRENGTH

Personal consumption and business fixed investment, the two types of spending expected to be most responsive to the major 1964 tax reduction, surged ahead in 1964 and 1965. Buoyancy in these sectors outweighed sluggishness in residential construction outlays and moderation in inventory investment (Table 1).

TABLE 1.—*Changes in gross national product since early 1961*

Expenditure group	1961 I	1963 IV	1965 IV [1]	Percentage change per year: 1961 I to 1965 IV [1]	Percentage change per year: 1963 IV to 1965 IV [1]
	Billions of dollars [2]				
Gross national product	503.6	603.6	694.6	7.0	7.3
Personal consumption expenditures	328.4	379.5	441.1	6.4	7.7
Private business fixed investment	45.0	56.8	73.2	11.3	13.5
Change in business inventories	−3.8	6.1	7.0	(3)	(3)
Residential structures	21.7	27.9	27.2	4.9	−1.3
Net exports of goods and services	6.6	7.3	7.4	(3)	(3)
Government purchases of goods and services	104.3	124.3	138.6	6.3	6.0
Federal	55.4	64.4	69.7	5.0	4.0
State and local	49.0	59.9	68.9	7.8	8.0

[1] Preliminary.
[2] Seasonally adjusted annual rates.
[3] Percentage change not computed because of small or negative base.

NOTE.—Detail will not necessarily add to totals because of rounding.

Sources: Department of Commerce and Council of Economic Advisers.

Consumption

The consumer was a bulwark in the strong general economic gains of 1964 and 1965. Except for the fourth quarter of 1964, when strikes cur-

tailed automobile sales, consumption grew by $7 billion or more in every quarter of this period. Only twice before, once at the start of the Korean war and again at the beginning of 1959, had quarterly increases of this size occurred.

A notable feature of the recent sharp advance in consumption expenditures is its pervasiveness. The sharpest relative increases occurred in purchases of durables, which are generally most sensitive to fluctuations in the growth of income. From the end of 1963 to the end of 1965, real expenditures on automobiles toppled all previous records, rising on average by 11 percent a year. Yet this strong rise was closely paralleled by outlays for other durables. And real outlays on both nondurables and services rose at an unusually strong 5½ percent annual rate.

Consumers were able to take these forward strides because of rapid gains in their purchasing power. Real disposable income grew at an average annual rate of 6.3 percent in the 2 years after the 1964 tax cut, in contrast to the growth rate of 3.9 percent in the preceding 2 years. The consumer continued to be a dependable performer in the economy. During the past 2 years, the rise of almost $61 billion in consumption amounted to 91 percent of the $66 billion increase in disposable income. Spending on consumer goods and services has typically absorbed approximately this proportion of increases in disposable income, when allowance is made for some lag in adjustment to unusually large income gains.

TABLE 2.—*Changes in employment and income since early 1961*

[Seasonally adjusted]

Series	Unit	1961 I	1963 IV	1965 IV [1]	Percentage change per year	
					1961 I to 1965 IV [1]	1963 IV to 1965 IV [1]
Civilian labor force:						
Employment	Millions of persons	[2] 66.6	69.3	73.0	2.0	2.6
Unemployment	do	[2] 4.9	4.1	3.2	−8.4	−12.1
Personal income: [3]						
Total (before taxes)	Billions of dollars	406.6	475.6	546.0	6.4	7.1
Wage and salary disbursements	do	270.9	318.8	368.1	6.7	7.5
Disposable (after taxes)	do	354.8	414.0	480.3	6.6	7.7
Corporate profits: [3]						
Before taxes	do	45.0	60.8	[4] 74.6	[4] 11.9	[4] 12.4
After taxes	do	24.4	33.8	[4] 44.5	[4] 14.3	[4] 17.0

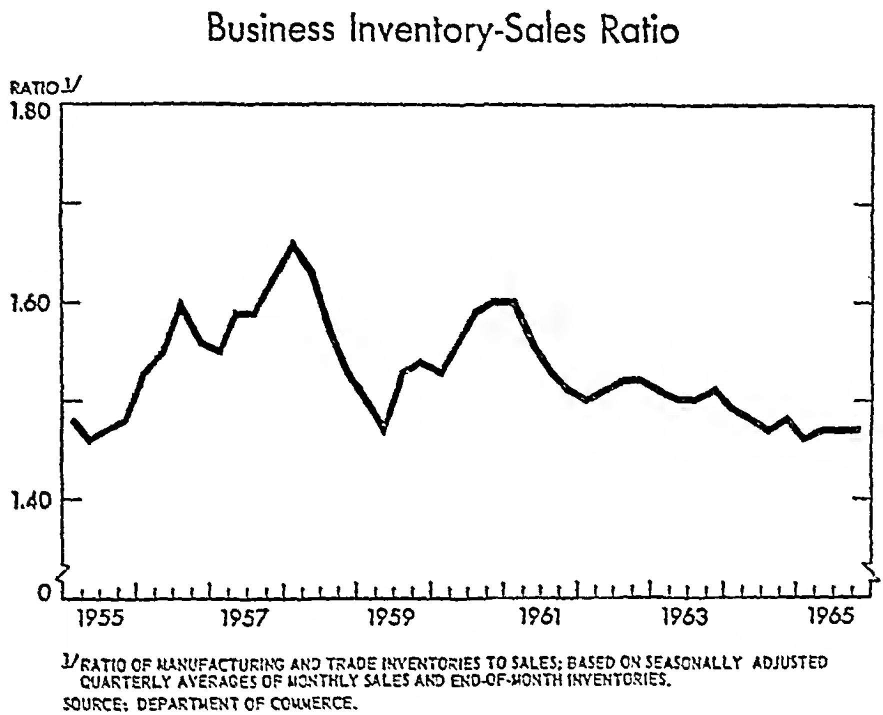
[1] Preliminary.
[2] Adjusted for comparability with subsequent data.
[3] Quarterly data at annual rates.
[4] Profits data relate to 1965 III.

Sources: Department of Labor, Department of Commerce, and Council of Economic Advisers.

The largest beneficiaries of the rapid rise in income were workers rescued from unemployment. Other consumers also benefited, although less dramatically, through lower taxes, higher wages, and fuller work schedules (Table 2). Thus, expansionary fiscal policies were translated for most Americans into rising standards of living—more and better provision of the physical necessities, the social amenities, and the per-

inventory investment of $7.1 billion was in line with the growth of final sales. As Chart 2 shows, inventory-sales ratios remained remarkably stable throughout the past 4 years, in marked contrast to the cyclical ups and

Chart 2



downs in the late 1950's. In recent years, businessmen's sales expectations were validated or surpassed by performance; moreover, prudent management helped to keep stocks closely geared to sales.

Residential construction was the only major component of private spending which remained weak in 1964 and 1965. In the 1961–63 period, the average annual addition of 1.46 million units to the private housing stock exceeded by an unusually large margin the average annual rate of net family formation (870,000). Excess supply developed in particular housing markets, especially in the West and in high priced apartments in scattered other locations. Thus, the upswing in residential construction activity ended early in 1964. The number of private housing starts fell from an annual rate of 1.7 million units in the first quarter of 1964 to a low of 1.4 million units in the third quarter of 1965. The real value of home construction held up somewhat better—because of a shift toward bigger and better quality new homes. Nevertheless, residential construction added practically nothing to the growth of GNP—even in current prices—in 1964, and was again a conspicuously lagging sector in 1965. . . .

The Balance of the Economy Today

The potential output of the American economy has continued to grow rapidly in the past 5 years. Aggregate demand, however, has advanced even faster. Output has risen to within 1½ percent of the economy's estimated potential. Meanwhile, private investment has forged ahead to match high-employment private saving. The good balances of demand with potential output and of investment with high-employment saving are two related measures of our progress.

Balance of Output and Potential

In 1965, the American economy achieved fuller utilization of its vast human and physical resources than at any time since 1957. Jobs were provided for more persons able and willing to work, thus leading to a more equitable distribution of the Nation's output and reducing the ranks of those unfairly condemned to a meager subsistence because they cannot find work. More and more Americans have had the chance to exercise their preference for employment rather than doles. Adult males had an unemployment rate of 5.7 per cent in 1961. The rate fell to 2.6 percent by the end of 1965, not because attitudes toward work were uplifted, but because opportunities for work widened greatly.

A high-employment economy generates benefits for the rest of the Nation as well as for the previously unemployed. The additional output directly attributable to the efforts of the reemployed is just one part of the larger output that accompanies increased employment. In addition, productivity is higher as a result of improved utilization, primarily reflecting the more efficient use of overhead labor, such as clerical, professional, maintenance, and managerial employees.

Improving employment opportunities also attract more persons into the job market and thus add to the measured labor force. Manpower supplies are further increased in periods of advancing activity by the lengthening of the work week, as part-time employees are converted to full-time and as overtime work increases.

In the last four Economic Reports, the Council has discussed the concept of potential GNP, defined as the volume of goods and services that the economy would ordinarily produce at the interim target unemployment rate of 4 percent. The measurement of potential GNP must incorporate the effects of the higher productivity, the larger labor force, and the fuller work schedules which accompany reduced unemployment.

Potential GNP does not stand still. Over time, population trends add to the number of persons in the labor force. Furthermore, increases in the quantity and quality of capital, advances in technology, and improvements in the quality of labor raise the potential productivity of the labor force.

The evidence indicates that, from the mid-1950's and into the early 1960's, the potential labor force grew at the rate of about 1¼ percent a year. Normal growth of man-hour productivity for the entire work force

(including Government as well as private workers) was 2½ percent a year. Hours worked a year trended downward at a rate of nearly one-fourth of 1 percent annually. Thus, potential GNP grew by 3½ percent a year.

For recent years, a real growth rate of actual GNP somewhat greater than 3½ percent has been required to hold the unemployment rate constant. Hence, the Council last year raised its estimated rate of growth of potential GNP to 3¾ percent, beginning in 1963. More rapid growth of the labor force will further increase the growth rate of potential GNP in the years ahead. During 1966, the Department of Labor will release a study, summarizing the results of extensive research on the prospects and patterns of growth by 1970.

The disparity or "gap" between potential and actual output (Chart 3) represents the goods and services foregone because of the underutilization of resources. The persistent gap since the mid-1950's has meant a total of $260 billion (in 1958 prices) in lost output. This loss was at a peak annual rate of $50 billion in the first quarter of 1961. The gap was reduced during the next few years. It shrank dramatically in 1965, reaching $10 billion, in the final quarter when the unemployment rate was 4¼ percent.

During the second half of 1965, unemployment fell somewhat more rapidly than would have been expected from the rate of advance of real GNP. It now appears likely that the unemployment rate will reach 4.0 percent while the trend calculation still shows a small GNP gap. Recent experience has been influenced by the expansion of the armed services and of Government antipoverty programs for training young unskilled workers, both of which have a stronger effect on unemployment than on output. Despite the discrepancy between the estimate of the gap and the movement of unemployment that emerged late in 1965, it is clear that the Council's estimates of the potential GNP associated with 4 percent unemployment have been close to the mark throughout the expansion. Potential output has proved to be quantifiable within a sufficiently narrow range to justify its use as a key concept in the analysis of stabilization problems and policies.

The 4 percent unemployment rate has been viewed consistently by the Administration as an interim target obtainable by aggregate demand policies *alone* without sacrificing essential price stability. But aggregate demand policies have *not* been alone. Other public and private policies have improved the functioning of markets and the skills of the labor force, as Chapters 2 and 3 explain in detail. These policies have now made prudent a reduction in the unemployment rate to a level below 4 percent. . . .

Views of President Johnson, Economic Report of 1967

Although the quest for price stability was featured in all of the reports, the 1967 Report gave greater relative emphasis to this objec-

tive, spurred on no doubt by the better than three percent increase in consumer prices during 1966, after a period of comparative stability for several years. The case for price stability is summarized as follows (pp. 11–13):

- For the year as a whole, slightly less of our resources than last year will be used to build new homes, although a sharp recovery in residential construction from its current deep recession is expected during the course of the year.

As the flow of goods and services to consumers expands, the ability of our elderly citizens to share in these gains will be supported by a rise of more than $6 billion in Social Security and Medicare payments.

In 1967, we will have no bonus dividend from using previously idle resources. But the dividend from growth alone is a big one. We must be sure we get it; and we must use it wisely.

RESTORING PRICE STABILITY

From the beginning of 1961 until 1965, the United States enjoyed both price stability and a strongly expanding economy. The average of wholesale prices hardly moved, and consumer prices rose only a little more than 1 percent a year. Last year, that record was blemished. Consumer prices rose 2.9 percent between 1965 and 1966, wholesale prices 3.2 percent.

When we were involved in Korea, consumer prices rose 8.0 percent between 1950 and 1951, wholesale prices 11.4 percent. And we had price controls during most of 1951.

Even when we were not at war, consumer prices rose 3.5 percent between 1956 and 1957, wholesale prices 2.9 percent.

Nevertheless, we are not satisfied with our record on prices. And we expect to improve on it this year.

There are many reasons why we refuse to tolerate rapidly rising prices:

- They injure those with fixed incomes, especially older people.
- They can lead to speculation and economic distortions which could undermine prosperity.
- They weaken our competitive position in world markets.
- As they persist, they become harder to stop without throwing the economy into reverse.

Restoring price stability is one of our major tasks. It will not be accomplished all at once, or all in 1967. That could be done—if at all—only at the cost of mass unemployment, idle machines, and intolerable economic waste. But a gradual return to stability can go hand in hand with steady economic advance.

Such an improvement will require

—prudent fiscal and monetary policies;

—Government efforts to help relieve the key points of pressure on prices;

—the responsible conduct of those in business and labor who have the power to make price and wage decisions.

With steady, sustainable, and balanced growth, we can look forward to

—relief of pressures on capacity in such strained areas as machinery and metals;

—adjustments of raw materials supplies to demand;

—the end of labor shortages in key areas.

Other efforts of the Federal Government can help to relieve particular pressures on prices and wages. We will continue

—to develop manpower training programs to meet skill shortages;

—to increase efficiency of the employment services in matching jobs and men;

—to handle Government procurement so as to minimize its pressure on prices;

—to dispose of surplus Government stockpiles to alleviate shortages of raw materials;

—to manage farm programs to assure adequate supplies as well as equitable returns.

But efforts of the Government alone will not be enough. The cooperation of business and labor is essential for success.

In the past year, most businessmen who had a choice in setting prices and most trade unions that negotiated wage contracts acted responsibly. They did so because they took account of the national interest and saw that it was also their own.

If business and labor were to consider only their own short-run interests

—each union might seek a wage increase which exceeds the most recent settlement by some other union:

—each business might strive to achieve a new profit record by translating strong demand into higher prices, whether or not costs have increased.

But when business and labor consider the national interest—and their own longer-run interests—they realize that such actions would have only one result: a wage-price spiral which is in the interest of neither.

- If unions now attempt to recoup in wages all of the past or anticipated advance in the cost of living—in addition to the productivity trend;
- If businesses now seek to pass along rising costs when it would be possible to absorb them or do not reduce prices when costs fall;

then the result will be just such a spiral—damaging to business, damaging to labor, and disastrous to the Nation.

Once again, I appeal to business and labor—in their own interest and that of the Nation—for the utmost restraint and responsibility in wage and price decisions. . . .

6. PRICES, COMPETITION, AND MARKET STRUCTURE

GIVEN THE PROPOSITION that full employment and economic stability are desirable goals for national economic policy, the next question is: How to achieve them? One approach argues that the price and market systems should be relied on to act as the allocators of resources and the determinants of efficiency in the economy. This is the approach of the free enterprise model. Dissenting groups argue that a substantial degree of governmental central planning must be introduced into the system to direct the allocation process. Hence, government should be given an increased role. The influence of prices (especially increases), competition, and market structure permeates all of the economic reports.

The 1962 Report examined these forces from the free enterprise approach; the subsequent reports provided for a greater relative role for positive governmental intervention.

Views of the Council of Economic Advisers, 1962

The Council's 1962 Report analyzed the important role played by prices in a free enterprise economy (pp. 167–169). The Council then went on further to detail the proposals for assuring that such a system might prevail (pp. 183–184).

PRICE BEHAVIOR IN A FREE AND GROWING ECONOMY

Price behavior embraces both changes in the over-all *level* of prices throughout the economy and changes in price *structure*—the relation of particular prices to each other. Changes in either the level or the structure of prices have far-reaching influences which can affect for better or worse the performance of a free economy. Both aspects of price behavior are closely related to major problems which confront the U.S. economy today.

Our success in solving the international payments problem (discussed in the previous chapter) will depend to a major extent on our ability to avoid inflation. To recognize this compelling reason for price stability is not to say that stable prices are desirable only for their contribution to the achievement of equilibrium in our balance of payments. Even creep-

ing inflation has effects on the distribution of income which are always capricious and often cruel, and it may generate perverse changes in the structure of prices. Galloping inflation is profoundly disruptive of economic efficiency and growth. But to these persisting arguments for avoiding inflation is now added the pressing and immediate need to strengthen the competitiveness of U.S. industry in world markets.

International competitiveness is affected by many considerations, including quality, variety, service, credit facilities, and promptness in delivery. But after full weight is given to these considerations, price remains at the heart of the matter. The effect of price developments on our international competitive position will not, of course, be determined by the behavior of U.S. prices alone; what counts is the change in the ratio of U.S. prices to the prices of those countries with which we compete in world markets. There is independent reason to expect in the next few years a moderate upward price trend in some competitive countries, but a decline in the ratio of our prices to theirs is obviously more likely if our own prices remain stable than if they rise.

Large potential gains in national economic welfare are at stake in the course of price developments over the next year or two. Stable prices—together with the many other measures to strengthen our payments position discussed in Chapter 3—will move us toward equilibrium in our international payments. This, in turn, will remove a possible impediment to the vigorous pursuit of full employment.

It is always possible to strengthen the balance of payments, at least for a time, by weakening the economy. Checking and reversing the economic expansion would reduce our demand for imports by reducing our demand for all goods and services. Raising interest rates sharply would probably attract some foreign capital to the United States, but it would raise the cost and reduce the volume of domestic expenditures for new business plant and equipment and residential construction. This road to balance of payments equilibrium endangers the interests of the whole Nation and specifically the interests both of labor and of business; for the former it increases unemployment, while for the latter it lowers profits. Both groups stand to gain from price level stability, which lays the foundation for the harmonious coexistence of balance of payments equilibrium with full employment and rapid economic growth.

Price level stability does not, of course, require stability of all prices. On the contrary, the structure of relative prices constitutes the central nervous system of a decentralized economy. Changing relative prices are the signals and stimuli which foster the efficiency and guide the growth of such an economy.

Changing relative prices serve to ration scare goods and services. They encourage consumers and business firms to economize on the use of things which have grown scarcer, and to use more freely those things which have become more abundant. They attract resources into the production of those things for which demand has increased, and encourage the outflow

of resources from the production of things for which demand has declined. They provide generous rewards to innovators, and then assure that the benefits arising from innovation are widely diffused throughout the economy. They direct economic activity into the most productive channels. A smoothly functioning price system, while it cannot solve all of the resource-use problems of our economy, is nevertheless an indispensable agent for reconciling decentralized private decision-making with national economic objectives.

In the context of current economic policy goals, flexible relative prices play an important role in encouraging maximum production and shaping the pattern of growth. As the economy approaches full utilization of productive resources, premature and stubborn bottlenecks may arise in some sectors while labor and capital are underutilized elsewhere. This danger is lessened if production resources are sufficiently mobile to shift promptly into the sectors of the economy which are coming under pressure. Flexible price and wage relationships are not in themselves sufficient to assure that capital and labor will flow from relatively declining to relatively expanding sectors. But flexible price and wage relationships can smooth the process, both by signaling the directions in which resource movements should occur, and by providing incentives to encourage such shifts. Prices must fall as well as rise, however, if changing relative prices are to play their role in guiding resource movements without forcing a steady rise in the over-all level of prices. . . .

Policies Affecting Price Behavior

The over-all stability of prices should be achieved in a manner consistent with the flexible response of individual prices and wage rates to changes in cost and demand within an environment of dynamic competition. Thus, government policies to promote price stability must work to maintain and increase the freedom of the private economy, not to limit it. In peacetime, attempts to stabilize prices through the imposition of direct wage and price controls or through interference with the rights of employees to organize and bargain collectively are unacceptable. Also unacceptable are policies which pursue price stability without regard for the effects on employment, production, and purchasing power. Prices might be stabilized in an underemployed economy; but to accept heavy unemployment and persistent slack as the necessary cost of price stability is to undermine the vitality and flexibility of the economy and to reduce American strength.

Competitive behavior throughout the economy involves more than rivalry among firms selling similar products in a single market; it also involves hard bargaining between firms buying and selling from each other and between firms and unions. Abridgement of competition may be evidenced as much in permissive wage increases which are simply passed along in higher prices as in agreements among firms to divide markets.

were started. Thousands more were discontinued or merged, or transferred their operations from one industry or locality to another.

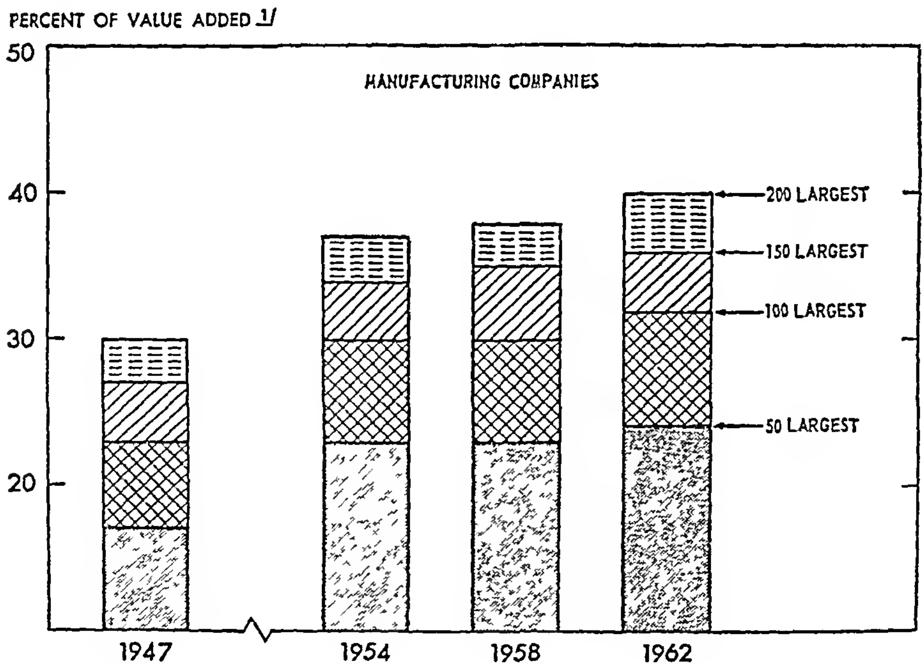
Within the important manufacturing sector, certain structural trends have emerged in the period since the end of World War II: (1) Through internal expansion and merger, large firms have grown more rapidly than the manufacturing sector as a whole. As a result, their share of the *total* market for all manufactured goods has risen. (2) Within some individual industries, the concentration of production in the hands of the 4 firms with the largest shares of the market has increased; in others it has decreased. Over-all, concentration within specific industries has shown no significant trend.

The market share of the 100 largest U.S. manufacturing firms has grown rapidly since World War II. Chart 14 shows that, between 1947

Chart 14

Shares of Largest Companies in Manufacturing

AS MEASURED BY VALUE ADDED



1/ VALUE ADDED IN MANUFACTURING
SOURCE: DEPARTMENT OF COMMERCE.

and 1962, their share of value-added in manufacturing grew from 23 percent to 32 percent. And their share of all manufacturing assets increased from 39 to 45 percent between 1950 and 1962. Partly this has resulted from expanding markets in a growing economy and from able and efficient management. It has resulted also from the postwar merger movement which will be discussed below.

Concentration within specific industries is frequently measured by the share of an industry's shipments attributable to the 4 firms with largest shipments. Table 18 shows that this measure of concentration has risen in some major manufacturing industries but fallen in others. In 1947, 24 percent of manufacturing shipments were in industries in which the 4 firms with largest shares of the market accounted for at least half the shipments. In 1958, the figure was 23 percent, indicating little, if any, trend during the period.

An important part of the explanation of these opposing movements—the increasing influence of large firms in total manufacturing activity while concentration in specific industries shows no significant trend—can be found in the size and character of the postwar merger movement. The Federal Trade Commission has recorded more than 11,000 mergers since 1948. Since 1950, the 200 largest industrial corporations have acquired more than 2,000 other concerns, and 257 of the 1,000 largest manufacturing corporations have disappeared through merger. Mergers of large firms grew rapidly in number and importance from the end of World War II until 1955, fell off briefly, and then continued to grow again after 1959.

TABLE 18.—*Concentration in selected industries, 1947 and 1958*

Industry	Value of shipments 1958 (millions of dollars)	Percent of value of shipments accounted for by 4 largest firms	
		1947	1958
Primary aluminum	802	100	(1)
Locomotives and parts	387	91	95
Tin cans and other tinware	1,804	78	80
Cigarettes	2,159	90	79
Computers	1,076	69	77
Motor vehicles and parts [2]	6,419	56	75
Tires and inner tubes	2,272	77	74
Aircraft engines	3,359	72	56
Steel works and rolling mills [2]	5,980	50	53
Electric appliances	755	36	43
Meat packing plants [2]	1,677	41	34
Cement, hydraulic	1,069	30	32
Petroleum refining	14,106	37	32
Machine tools	685	20	21

[1] Not available.
[2] Data are for value added rather than value of shipments.

Source: Department of Commerce.

Earlier merger movements were characterized largely by "vertical" acquisitions among firms that were in a buyer-seller relationship and by "horizontal" acquisitions among competing firms. Anticompetitive mergers of both kinds are now effectively prohibited by our antitrust laws. Many of the more recent mergers, however, have been "conglomerate"—that is, the acquisition by one firm of another in an unrelated product line, normally to achieve economies of management or sales or diversification of risks. These, too, are subject to the antitrust laws, but their effects

nomics and the law. Sound economic analysis needs to be used to define the relevant market, to assess the extent of concentration and barriers to entry of new firms, and to evaluate business policies. Equally important is the development of sound economic criteria for the selection and preparation of antitrust cases, since the desirability of many business actions depends on their economic setting and significance. . . .

DETERMINATION OF THE PRICE LEVEL

The relation between the volume of economic activity and the price level is not simple. As a first approximation, the classical law of supply and demand leads one to expect that the change in the price level will depend mainly on the size of the gap between capacity and actual output. The more production falls short of potential—i.e., the greater is excess productive capacity—the further prices should drop. Conversely, when demand outruns aggregate supply, the imbalance should raise prices. History shows that things are rather more complicated. For example, the second half of 1955 was a period when there was no gap between potential production and actual production, yet the GNP deflator—our most comprehensive indicator of the price level—rose little. In 1957 and 1958, when the gap was beginning to assume considerable size, the GNP deflator rose substantially. The GNP deflator rose at a fairly steady and modest pace, both in the years when the gap was large—in 1958–61—and when it narrowed substantially—from 1961 to 1965. Clearly, more detailed analysis is necessary.

Some important components of the price level have risen continuously over the years, particularly in construction, services, and Government. Other components of the price level, especially agricultural and some raw material prices, are influenced by supply conditions which move relatively independently of the general economy.

The industrial component of the price level has proved to be most systematically responsive to the general degree of prosperity. But even industrial prices cannot be accurately predicted by reference to levels of activity alone. For example, industrial prices have been much more stable for any given degree of utilization of industrial capacity in the last 5 years than in the preceding decade.

Views of the Council of Economic Advisers, 1967

In its 1967 Report, the Council of Economic Advisers stressed the importance of competition as a basic ingredient of economic growth and progress. The pages (113–115) excerpted below depict this point of view.

IMPROVING THE PERFORMANCE OF PRODUCT MARKETS

Progress toward the goal of fuller utilization of resources along with price stability will require improving the performance not only of labor markets but of product markets as well.

ducers of other products and services. In today's world of rapid technological change, completely new products or services—often produced by firms in another industry—may provide the strongest competition for established products (for example, plastics with metals, automatic washers with laundries, television with movies).

The intensity of competition has been substantially increased in recent years by the growth of international trade and the gradual reduction of barriers to such trade. U.S. firms seek markets all over the world and foreign firms are increasingly active in U.S. markets.

Actual and potential competition is a powerful force restraining unnecessary price increases, promoting product improvement, and inducing firms to seek efficiency and to find new methods for producing at lower cost. The effectiveness of competition is maintained and increased through vigorous enforcement of the antitrust laws.

It is essential to apply the law against collusion among competitors to fix prices or to share markets. Antitrust efforts are also designed to combat practices which strengthen market power through reducing the number of firms in an industry, which erect artificial barriers to the entry of potential competitors, which delay the introduction of superior products or cost reducing techniques, or which serve to blunt the effectiveness of competitive price changes. Such practices raise prices for consumers or reduce the quality of goods which people can buy.

The antitrust statutes assume particular importance in an economy operating near the limits of its capacity. Their vigorous enforcement can counter a possible inflationary bias in product markets by sustaining and strengthening competition. Antitrust activities should continue to be focused on this main purpose. In particular, effective antitrust cannot provide for the protection of individual competitors at the expense of the protection of competition.

In some areas, unfortunately, the thrust of protective efforts has been diverted. For example, during the early 1930's many States acted to restrict competition in the field of retail distribution when the pervasive economic distress bankrupted many small firms and threatened countless others with failure. Relief was sought, and frequently obtained, in the form of restrictions on the pricing policies of larger and more efficient firms—especially chain stores and mail order houses. . . .

7. WAGE-PRICE GUIDEPOSTS

One of the most influential of all policy statements found in the economic reports is that relating to the idea of *wage-price guideposts* as first presented in the 1962 Report. Many collective bargaining sessions, particularly in industries of national importance, have spent countless hours arguing the pros and cons of these guideposts for setting the parameters for wage increases.

Although each report, beginning with the one for 1947, emphasized the importance of price stability and discussed the relationships between wages, costs, and prices, it was not until the 1962 Report that President Kennedy specified the wage-price guideposts as a positive feature of national economic policy.

It should be pointed out that, in his reports, President Eisenhower referred a number of times to the importance of productivity changes as related to wages and to real gains in the economy. The specific formulation of a set of guideposts was not provided until the 1962 Report, however.

Statement of President Kennedy, Economic Report of 1962

The idea that productivity gains should be the benchmarks for wage advances was presented as a general statement (p. 17) in the 1962 Report. We observe here the statement that ". . . the road to higher real profits and higher real wages is the road of increased productivity." Later, President Kennedy expressed the hope that ". . . labor leaders . . . will accept the productivity benchmark as a guide for wage objectives. . . ."

> . . . All of us have learned a great deal from the economic events of the past 15 years. Among both businessmen and workers, there is growing recognition that the road to higher real profits and higher real wages is the road of increased productivity. When better plant and equipment enable the labor force to produce more in the same number of hours, there is more to share among all the contributors to the productive process—and this can happen with no increase in prices. Gains achieved in this manner endure, while gains achieved in one turn of the price-wage spiral vanish on the next.
>
> The Nation must rely on the good sense and public spirit of our busi-

ness and labor leaders to hold the line on the price level in 1962. If labor leaders in our major industries will accept the productivity benchmark as a guide to wage objectives, and if management in these industries will practice equivalent restraint in their price decisions, the year ahead will be a brilliant chapter in the record of the responsible exercise of freedom. . . .

Views of the Council of Economic Advisers, 1962–1964

The Council also recognized the importance of gains in productivity as the basis for raising real wages (1962, p. 174). The Council then went on further to present a fuller discussion of "guideposts for noninflationary wage and price behavior" (pp. 185–190). Note how the Council arrived at permissible percentage increases as well as the possible modifications.

Wage and Cost Developments in Perspective

Wages and salaries are at the same time the principal cost to employers, the main source of income to employees, and the major source of demand to the economy as a whole.

If living standards are to rise over time, real wages must increase. Stability in the general price level means, therefore, that average money wage rates should follow a generally rising path. As output per man-hour increases, rising money wage rates can be absorbed into stable labor costs per unit of output. So long as unit labor costs do not increase, rising wages are fully compatible with stability in the price level.

Whatever its cause, a rising price level is characteristically accompanied by a rate of wage increase in excess of the rate of increase in output per man-hour. It is quite true, of course, that when employment costs per man-hour rise more rapidly than output per man-hour, prices sooner or later will increase. But it is equally true that, when prices are pulled up by excess demand, competition for labor will tend to raise employment costs per man-hour faster than output per man-hour increases. Thus wage increases will tend to outstrip productivity increases *both* when the inflationary pressures arise from cost and when they arise from demand. The mere coexistence of rising prices and wages rising faster than productivity tells nothing about causation. . . .

Guideposts for Noninflationary Wage and Price Behavior

There are important segments of the economy where firms are large or employees well-organized, or both. In these sectors, private parties may exercise considerable discretion over the terms of wage bargains and price decisions. Thus, at least in the short run, there is considerable room for the exercise of private power and a parallel need for the assumption of private responsibility.

Individual wage and price decisions assume national importance when

they involve large numbers of workers and large amounts of output directly, or when they are regarded by large segments of the economy as setting a pattern. Because such decisions affect the progress of the whole economy, there is legitimate reason for public interest in their content and consequences. An informed public, aware of the significance of major wage bargains and price decisions, and equipped to judge for itself their compatibility with the national interest, can help to create an atmosphere in which the parties to such decisions will exercise their powers responsibly.

How is the public to judge whether a particular wage-price decision is in the national interest? No simple test exists, and it is not possible to set out systematically all of the many considerations which bear on such a judgment. However, since the question is of prime importance to the strength and progress of the American economy, it deserves widespread public discussion and clarification of the issues. What follows is intended as a contribution to such a discussion.

Mandatory controls in peacetime over the outcomes of wage negotiations and over individual price decisions are neither desirable in the American tradition nor practical in a diffuse and decentralized continental economy. Free collective bargaining is the vehicle for the achievement of contractual agreements on wages, fringes, and working conditions, as well as on the "web of rules" by which a large segment of industry governs the performance of work and the distribution of rewards. Similarly, final price decisions lie—and should continue to lie—in the hands of individual firms. It is, however, both desirable and practical that discretionary decisions on wages and prices recognize the national interest in the results. The guideposts suggested here as aids to public understanding are not concerned primarily with the relation of employers and employees to each other, but rather with their joint relation to the rest of the economy.

Wages, prices, and productivity. If all prices remain stable, all hourly labor costs may increase as fast as economy-wide productivity without, for that reason alone, changing the relative share of labor and nonlabor incomes in total output. At the same time, each kind of income increases steadily in absolute amount. If hourly labor costs increase at a slower rate than productivity, the share of nonlabor incomes will grow or prices will fall, or both. Conversely, if hourly labor costs increase more rapidly than productivity, the share of labor incomes in the total product will increase or prices will rise, or both. It is this relationship among long-run economy-wide productivity, wages, and prices which makes the rate of productivity change an important benchmark for noninflationary wage and price behavior.

Productivity is a *guide* rather than a *rule* for appraising wage and price behavior for several reasons. First, there are a number of problems involved in measuring productivity change, and a number of alternative measures are available. Second, there is nothing immutable in fact or in

justice about the distribution of the total product between labor and nonlabor incomes. Third, the pattern of wages and prices among industries is and should be responsive to forces other than changes in productivity.

Alternative measures of productivity. If the rate of growth of productivity over time is to serve as a useful benchmark for wage and price behavior, there must be some meeting of minds about the appropriate methods of measuring the trend rate of increase in productivity, both for industry as a whole and for individual industries. This is a large and

TABLE 26.—*Annual rates of growth of output per man-hour, 1909 to 1960*

[Based on establishment series]

Industry series	Average annual percentage change [1]			
	1909 to 1960	1947 to 1960	1947 to 1954	1954 to 1960
Total private economy	2.4	3.0	3.5	2.6
Nonagriculture	2.1	2.4	2.7	2.2
Nonmanufacturing	(2)	2.2	2.6	1.9
Manufacturing	(2)	2.8	2.9	2.9
Manufacturing corrected for varying rates of capacity utilization	(2)	2.8	2.8	3.1

[1] Computed from least squares trend of the logarithms of the output per man-hour indexes. See Table B-31 for indexes for 1947-60.
[2] Not available.

Sources: Department of Labor and Council of Economic Advisers.

complex subject and there is much still to be learned. The most that can be done at present is to give some indication of orders of magnitude, and of the range within which most plausible measures are likely to fall (Table 26).

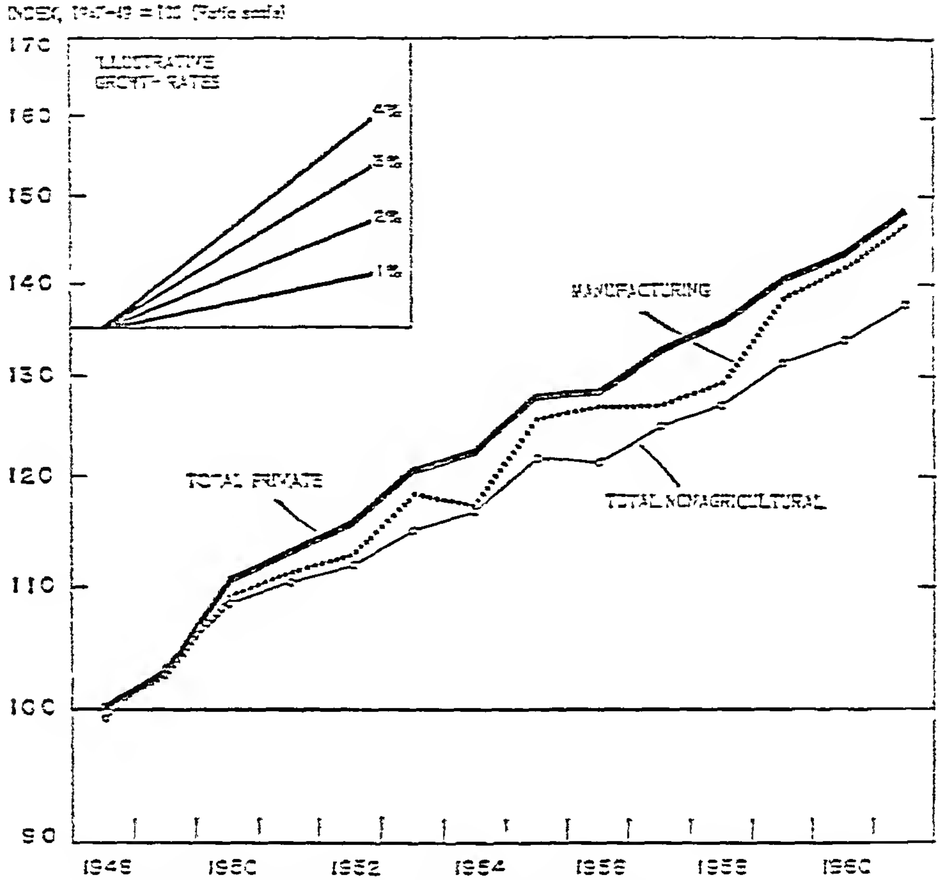
There are a number of conceptual problems in connection with productivity measurement which can give rise to differences in estimates of its rate of growth. Three important conceptual problems are the following:

(1) Over what time interval should productivity trends be measured? Very short intervals may give excessive weight to business-cycle movements in productivity, which are not the relevant standards for wage behavior. The erratic nature of year-to-year changes in productivity is shown in Chart 14. Very long intervals may hide significant breaks in trends; indeed in the United States—and in other countries as well—productivity appears to have risen more rapidly since the end of the second World War than before. It would be wholly inappropriate for wage behavior in the 1960's to be governed by events long in the past. On the other hand, productivity in the total private economy appears to have advanced less rapidly in the second half of the postwar period than in the first.

(2) Even for periods of intermediate length, it is desirable to segregate

CHART 14

Indexes of Output per Man-Hour



NOTE: MAN-HOURS ESTIMATES BASED PRIMARILY ON ESTABLISHMENT DATA.
SOURCE: DEPARTMENT OF LABOR.

the trend movements in productivity from those that reflect business-cycle forces. Where the basic statistical materials are available, this problem can be handled by an analytical separation of trend effects and the effects of changes in the rate of capacity utilization.

(3) Even apart from such difficulties, there often exist alternative statistical measures of output and labor input. The alternatives may differ conceptually or may simply be derived from different statistical sources. A difficult problem of choice may emerge, unless the alternative measures happen to give similar results.

Selected measures of the rate of growth of productivity in different sectors of the economy for different time periods are shown in Table 26. Several measures are given because none of the single figures is clearly superior for all purposes.

The share of labor income. The proportions in which labor and nonlabor incomes share the product of industry have not been immutable throughout American history, nor can they be expected to stand forever

where they are today. It is desirable that labor and management should bargain explicitly about the distribution of the income of particular firms or industries. It is, however, undesirable that they should bargain implicitly about the general price level. Excessive wage settlements which are paid for through price increases in major industries put direct pressure on the general price level and produce spillover and imitative effects throughout the economy. Such settlements may fail to redistribute income within the industry involved; rather they redistribute income between that industry and other segments of the economy through the mechanism of inflation.

Prices and wages in individual industries. What are the guideposts which may be used in judging whether a particular price or wage decision may be inflationary? The desired objective is a stable price level, within which particular prices rise, fall, or remain stable in response to economic pressures. Hence, price stability within any particular industry is not necessarily a correct guide to price and wage decisions in that industry. It is possible, however, to describe in broad outline a set of guides which, if followed, would preserve over-all price stability while still allowing sufficient flexibility to accommodate objectives of efficiency and equity. These are not arbitrary guides. They describe—briefly and no doubt incompletely—how prices and wage rates would behave in a smoothly functioning competitive economy operating near full employment. Nor do they constitute a mechanical formula for determining whether a particular price or wage decision is inflationary. They will serve their purpose if they suggest to the interested public a useful way of approaching the appraisal of such a decision.

If, as a point of departure, we assume no change in the relative shares of labor and nonlabor incomes in a particular industry, then a general guide may be advanced for noninflationary wage behavior, and another for noninflationary price behavior. Both guides, as will be seen, are only first approximations.

The general guide for noninflationary wage behavior is that the rate of increase in wage rates (including fringe benefits) in each industry be equal to the trend rate of over-all productivity increase. General acceptance of this guide would maintain stability of labor cost per unit of output for the economy as a whole—though not of course for individual industries.

The general guide for noninflationary price behavior calls for price reduction if the industry's rate of productivity increase exceeds the over-all rate—for this would mean declining unit labor costs; it calls for an appropriate increase in price if the opposite relationship prevails; and it calls for stable prices if the two rates of productivity increase are equal.

These are advanced as general guideposts. To reconcile them with objectives of equity and efficiency, specific modifications must be made to adapt them to the circumstances of particular industries. If all of these

behavior. But when a disagreement between management and labor is resolved by passing the bill to the rest of the economy, the bill is paid in depreciated currency to the ultimate advantage of no one.

It is no accident that productivity is the central guidepost for wage settlements. Ultimately, it is rising output per man hour which must yield the ingredients of a rising standard of living. Growth in productivity makes it possible for real wages and real profits to rise side by side.

Rising productivity is the foundation of the country's leadership of the free world, enabling it to earn in world competition the means to discharge its commitments overseas. Rapid advance of productivity is the key to stability of the price level as money incomes rise, to fundamental improvement in the balance of international payments, and to growth in the Nation's capacity to meet the challenges of the 1960's at home and abroad. That is why policy to accelerate economic growth stresses investments in science and technology, plant and equipment, education and training—the basic sources of future gains in productivity. . . .

In its 1963 Report, the Council commented further on the idea of wage-price guideposts (pp. 85–86) as follows:

To aid public understanding, the 1962 Economic Report concluded (pp. 185–90) with a set of "guideposts for noninflationary wage and price behavior." These guideposts were designed to provide standards for evaluating those price and wage decisions where the public has an interest in their content and consequences. They cannot, and should not, replace the normal processes of free private decisions and negotiations.

As the margin of unemployed labor and idle capital narrows, and as markets for goods and services become tighter, the guideposts will gain in importance. They are restated here in the belief that an enlightened public understanding of the nature and causes of inflation would be an additional force minimizing any inflationary threats in the years ahead.

The guide posts themselves involve *general* guides for noninflationary wage and price behavior, subject, in each case, to a number of important and specific *qualifications* required by the objectives of equity and efficiency.

The general guide for wages is that "the rate of increase in wage rates (including fringe benefits) in each industry be equal to the trend rate of over-all productivity increase." Under these conditions the gain from increases in productivity throughout the economy would be shared between wage and nonwage incomes by allowing each to grow at the same percentage rate. Each sector of economic life would share in the gains of advancing productivity. The qualifications call for faster increases in wage rates in an industry that (a) would otherwise be unable to attract sufficient labor to meet demands for its products, or (b) currently pays wage rates exceptionally low compared with those earned elsewhere by labor of similar ability. Symmetrically, increases in wage rates would fall

short of the general guide rate in an industry that (a) could not provide employment for its entire labor force even in generally prosperous times; or (b) currently pays wage rates exceptionally high compared with those earned elsewhere by labor of similar ability.

The general guide for prices is that prices should fall in an industry whose rate of productivity increase exceeds the over-all rate, rise in the opposite case, and remain stable if the two rates of productivity increase are equal. The qualifications call for a faster price increase or slower price decrease in an industry in which (a) the level of profits is insufficient to attract the capital required to meet expansion of demand, or (b) costs other than labor costs have risen. On the other hand, increases in price would be slower or decreases faster than indicated by the general guide in an industry in which (a) productive capacity exceeding full-employment demands an outflow of capital to be desirable, or (b) costs other than labor costs have fallen, or (c) excessive market power has resulted in rates of profit substantially higher than those earned elsewhere on investments of comparable risk.

The 1964 Report (p. 11) called for a continuation of the observance of the wage-price guideposts.

I count on the sense of responsibility of the Nation's industrialists and labor leaders

—to extend the excellent price and cost records of recent years

—to maintain price and wage policies that accord with the non-inflationary guideposts that I have asked the Council of Economic Advisers to reaffirm in its attached Report.

In the face of a 44 percent increase in corporate profits in less than three years and the prospect of further increases to come with the tax cut, I see no warrant for inflationary price rises.

On the heels of solid increases in real wages, plus the rise in take-home pay under the tax cut, I see no warrant for inflationary wage increases.

Accordingly:

—I shall keep a close watch on price and wage developments, with the aid of an early warning system which is being set up in the appropriate agencies.

—I shall not hesitate to draw public attention to major actions by either business or labor that flout the public interest in non-inflationary price and wage standards.

—And I shall translate into action the view

a. that antitrust policy must remain keenly alert to illegal price-fixing and other practices that impair competition;

b. that we must resist new steps to legalize price-fixing where competition should prevail.

Price and wage problems were considered in the Council's 1964 Report (pp. 116–118). These problems were approached primarily

from the point of view of inflation and the necessity for developing anti-inflationary policies if full employment is to be achieved.

ANTI-INFLATIONARY POLICIES FOR HIGH EMPLOYMENT

It is the business of responsible government to try to achieve the best possible balance among such major economic objectives as full employment, economic growth, reasonable price stability, and the promotion of economic freedom and opportunity. The importance of price stability as compared with the other goals is sometimes minimized. But there are compelling reasons why we can ill afford to neglect prices.

THE NEED FOR STABILITY

First, inflation redistributes real incomes and wealth arbitrarily. When prices rise, those groups that are able to expand profits and wages most rapidly improve their situation at the expense of those whose incomes respond slowly. Inflation erodes the real value of public assistance and makes it difficult for local governments to maintain adequate standards of education and other essential services. It also reduces the purchasing power of retirement pensions and other fixed incomes—in effect, subjecting them to a discriminatory tax. Fixed-income assets lose value, while the prices of equity securities and other properties rise.

A second cost of inflation that we cannot afford is its adverse impact on our balance of trade and on our balance of payments. During most of the 1950's the pricing of American industrial products caused some loss of competitive ground to the products of other industrial countries. From 1953 to 1958, the over-all wholesale price index rose only moderately more than the comparable indexes in most Western European countries and Japan. But the prices of certain goods important among U.S. exports rose substantially faster in the United States than in most of the countries with which we compete. Table 22 indicates the deterioration of our rela-

TABLE 22.—*Changes in wholesale prices in selected industrialized countries, 1953 to 1958*

	Percentage change in wholesale prices		
	Total	Steel	Machinery and equipment [1]
United States	8.3	24.0	20.2
France [2]	9.8	5.2	5.1
Italy	.9	(3)	2.5
Japan [4]	−1.3	[5] 16.5	[6] 6.8
United Kingdom	11.4	1.8	18.2
West Germany	3.0	9.1	6.0

[1] Implicit deflator for machinery and equipment component of gross national product used for all countries except Japan.
[2] Adjusted for change in exchange rate in 1958.
[3] Not available.
[4] Change from 1954 to 1958.
[5] Iron and steel.
[6] Machinery.

Sources: Organization for Economic Cooperation and Development, Japanese Economic Planning Agency, and Council of Economic Advisers.

tive price position particularly in the crucial areas of steel and machinery and equipment during the period 1953 to 1958.

Since 1958 the relative movement of over-all prices has begun to be reversed, partly because our unit labor costs have declined in comparison with those in most European countries (Chart 12, Chapter 5). The competitive price position of American producers has improved both in their home markets and overseas. It would be foolishly complacent, however, to believe that these recent gains can be extended, or even retained, without special effort. The European countries have been striving to establish rigorous "incomes policies" to restrain wages and prices. Despite recent setbacks, they will continue to press these efforts. In doing so, some European nations are willing to accept substantial interventions into private decision making. The United States is not. If we would compete with them successfully over the long pull, we shall need to achieve a high degree of price stability by means that are consistent with our traditions and values.

A third cost of inflation that we can ill afford is the compromise it could impose on our pursuit of full production and full employment. If cost and price pressures should arise through the exercise of market power while the economy is still climbing toward high output and employment levels, we would be forced once more into the dreary calculus of the appropriate trade-off between "acceptable" additional unemployment and "acceptable" inflation. This could result in a seirous setback to attainment of our national goals.

The choice for key private decision makers is clear. It is a particularly critical choice as the economy, after 6 years of excessive slack and unemployment, progresses toward full employment after enactment of the tax cut. For several years now many observers, including many leaders of the business and labor communities, have been saying that we have solved the cost-push inflation problem that appeared in the mid-fifties to have become endemic. This hopeful appraisal could not be demonstrated conclusively in a period when unemployment averaged 6 percent. But, given a combination of private and public efforts, we will have the opportunity to prove it in 1964 and later years.

GOVERNMENT ACTIONS

For its part, the Government will be striving energetically to reinforce one of the most significant comparative advantages that the American economy has over nearly all other industrialized nations—namely, a tradition and an institutional structure that nurture vigorous internal competition.

In the period ahead the Administration plans actively to enforce the Nation's antitrust laws, in part choosing its cases and concentrating its enforcement energies so as to curb price-fixing and those proposed mergers and other business practices and structures that tend to make for anticompetitive enhancement of prices. Likewise, it will resist proposals—

such as the revival of resale price maintenance now before the Congress in the so-called Quality Stabilization Bill—that would inhibit price competition and reduce the competitive vitality of our marketing system. In its efforts to promote freer international trade the Government typically is not unmindful of the effects that import competition has on domestic American pricing practices. And it will continue to promote and encourage vigorous price competition by United States exporters.

At the same time, existing, expanding, and new labor market programs, already enacted by the Congress or proposed by the Administration, will help firms meet their labor needs without raising costs and prices. These programs will increase labor mobility, provide opportunities for training and retraining, and improve education at all levels.

The Government also will be making a determined and continuing effort . . . to promote what are by all odds the best anti-inflationary measures of all—large and sustainable productivity improvements, which allow both wages and profits to increase with stable prices. The pending tax bill will have a major effect of this kind through its lasting stimulus to investment.

Finally, as the economy's single largest buyer of goods and services, the Federal Government will redouble its efforts in 1964 to get full value for each dollar it spends.

Views of President Johnson, Economic Report of 1965

Just as in the several predecessor reports, the 1965 Report by the President also expressed faith in the wage-price guideposts, as follows (p. 15):

I count on the sense of public responsibility of our labor leaders and our industrial leaders to do their full part to protect and extend our price stability.

Reasonable price and wage guideposts are again spelled out in the accompanying Report of the Council of Economic Advisers. *I commend them to the attention of the American public and of leaders of labor and industry.*

With the help of the Council and of other agencies of Government, I intend

—to maintain a close watch on wage and price developments;
—to draw public attention to those private actions which threaten the public interest;
—to ask, as I have recently done in the case of steel prices, for special, detailed analysis of price or wage increases in key sectors of the economy; and
—to oppose legislative enactments that threaten to raise costs and prices and to support those that will stabilize or reduce costs and prices.

Views of the Council of Economic Advisers, 1965–1967

The Council continued to express hope in the wage-price guideposts (1965, pp. 58–59), although it did recognize that departures were beginning to appear in actual wage contracts.

> Despite occasional exceptions—as in automobiles and construction—the general pattern of recent wage and price changes has closely approximated the Government's wage-price guideposts.
>
> To be sure, the guideposts have not been completely effective either in stimulating all warranted price reductions, or in preventing some individual wage and price increases that are not in accord with their criteria. Nevertheless, the very fact that representatives of both labor and management have often explicitly indicated their compliance with, or tried to justify any deviations from, the guidepost standards suggests that these standards have had a useful influence.
>
> In addition to any direct influence that they may have had on the wage and price policies of unions and managements, the guideposts have helped to create a new climate of opinion. Many groups in our society now have a better understanding of the relationships between costs and prices. There is increasing realization that it is appropriate—indeed necessary—to consider whether a proposed course of action, if followed by others in similar circumstances, would be consistent with over-all stability. Decision makers in unions and managements are increasingly aware both of the fact that their decisions affect the public interest and of the fact that the public is interested in their decisions.

By 1965 and 1966 it became increasingly apparent that a number of union leaders had become unwilling to accept the limitations of these guideposts. Some exceptions already had appeared in several key industries. The 1966 Report recognized some of the problems of administering these guideposts and suggested classes of permissible wage increases (pp. 108–110).

The 1966 Report (pp. 88–91) presented an excellent summary of the theory and results of practice associated with the use of these guideposts, as well as presenting indications for future public policy.

> *Price-wage guideposts*
>
> To deal with the problem of reconciliation—achieving noninflationary price and wage behavior under prosperous conditions—the Council's Annual Report in 1962 advanced the guideposts which were endorsed by President Kennedy and have been firmly restated by President Johnson.
>
> The basic guideposts are simple and straightforward and contain an inescapable economic logic.
>
> 1. *The general guide for wages is that the percentage increase in total*

employee compensation per man-hour be equal to the national trend rate of increase in output per man-hour.

If each industry follows this guidepost, unit labor costs in the over-all economy will maintain a constant average.

2. *The general guide for prices calls for stable prices in industries enjoying the same productivity growth as the average for the economy; rising prices in industries with smaller than average productivity gains; and declining prices in industries with greater than average productivity gains.*

If each industry follows this guidepost, prices in the economy will maintain a constant average.

Some exceptions to these guideposts are necessary to promote an efficient allocation of resources and a high rate of growth, and to redress inequities which have kept certain workers at the bottom of the wage scale. Wage increases above the guidepost level may be necessary where an industry is unable to attract sufficient labor to meet the demands for its products, where wages are particularly low, and where changes in work rules create large gains in productivity and substantial human costs requiring special adjustment of compensation. Because the industries in which market power is concentrated are largely high-wage industries with a relatively low long-term rate of increase of employment, the first two of these exceptions are rarely applicable.

On the price side, increases in price above the guidepost may be necessary to allow for increases in nonlabor costs or to correct an inability to attract needed capital.

Each of these exceptions has a symmetrical counterpart calling for downward departures from the guideposts. Wages should rise less than the guidepost rate where an industry suffers from above-average unemployment and where wages are exceptionally high for the type of work. Price increases should be smaller—or price decreases larger—where unit nonlabor costs fall, where capacity is too large, and where profits are based on excessive market power.

The guideposts are not meant to preclude the possibility of a change in distribution of income between labor and capital in industry. Where one side or the other is able to increase its share of industry income, but not at the expense of the public, the national interest need not be involved. However, it should be kept in mind that in most concentrated industries the division of income between labor and capital remained essentially unchanged all through the wage-price spirals of the 1950's. The repeated attempts to alter income shares proved self-defeating: neither side gained, and both lost through higher prices, weaker markets, reduced profits, and lower employment.

Table 12 illustrates the postwar experience with prices, wages, and productivity in the United States. Recent changes in employee compensation have conformed to productivity gains much more closely than in the 1950's, and price increases have been much more modest.

GUIDEPOSTS FOR NONINFLATIONARY PRICE AND WAGE BEHAVIOR

Most earlier periods of high employment since World War II have been accompanied by inflation. In some of those years, the cause clearly was excessive demand. In other years, no general excess of demand was evident, yet prices continued to creep upward. The movement continued even during some periods in which—on any reasonable criterion—over-all demand was quite inadequate. The exact diagnosis remains a matter of some disagreement among economists. But almost all agree that an important part of the explanation lies in the fact that, in many industries, unions or managements or both possess considerable discretionary power to set wages and prices, and that in too many instances they have used that power to raise wages and prices in ways not consistent with basic supply and demand forces in the market.

The apparent "inflationary bias" in our wage-making and price-making institutions has been of almost continuous concern for the Council of Economic Advisers for many years. Appeals for responsibility and moderation—for taking the public interest into account in wage and price decisions—have had a perennial place in successive Economic Reports. In its Annual Report of January 1962, the Council for the first time attempted to provide private decisionmakers with rather more specific standards for judging whether their decisions were responsible and took adequate account of the public interest. These standards or "guideposts" were also designed to permit the public to reach its own conclusions concerning the degree of responsibility exercised by leaders of business and labor.

Increasing Importance of the Guideposts

In the years since 1962, the guideposts have gained increasing significance. The slow and difficult progress in restoring equilibrium in our international balance of payments has underlined the necessity that American goods retain or improve their competitive position in export markets and in our own market. Our goal of balance of payments equilibrium in 1966 and thereafter will permit no retreat from cost-price stability.

During the recent years of still excessive unemployment and idle capacity, strong competition for jobs and markets reinforced a growing sense of responsibility on the part of labor and management. The fuller use of resources achieved last year and the excellent prospects for 1966 may reduce that reinforcement. We now confront the task of reconciling full employment with stable prices.

The record reviewed in previous sections of this chapter makes it clear that the overwhelming majority of private wage and price decisions in recent years has been consistent with the guideposts, whatever the extent

to which the guideposts may have consciously entered into the decisions reached. It is clear, however, that in many instances the guideposts have consciously affected these decisions. On numerous occasions, Government officials have specifically reminded unions or managements of the guidepost standards—either publicly or privately, either generally or with reference to specific situations. Several of the more important of these situations have attracted considerable public attention.

In January 1965, the President requested the Council of Economic Advisers to prepare an analysis of steel prices, following certain increases in such prices and at a time when important wage negotiations were pending. The Report, made public in early May, analyzed the position of the industry and the factors affecting it. It showed that wage and price decisions consistent with the guideposts would be in the interest of both labor and management and of the Nation. Later, the Government helped the two parties to reach a peaceful settlement in the steel wage negotiations. A damaging strike was avoided, and a settlement was achieved within the wage guideposts. According to the best estimates of its cost available to the Government, the settlement averaged 3.2 percent a year, computed over the full 39-month period.

Following the labor settlement, prices on tin plate were raised in October; this was accompanied by a price reduction on a new black plate, which is expected to substitute increasingly for tin plate in many uses. At the year's end, the Bethlehem Steel Company announced a $5 a ton increase on structural steel and pilings. The Council pointed out that such an increase was not justified under the guideposts. In January, the U.S. Steel Corporation announced a smaller increase, accompanying it with price reductions on other steel products.

In October, the Council prepared a guidepost analysis of price increases initiated by producers of primary aluminum; the companies later rescinded these increases.

Also in October, the President, by threatening a veto, persuaded the Congress to enact a pay increase for civil service and postal employees of the Federal Government which was within the guideposts.

These actions and many others clearly reaffirmed the Administration's strong commitment to the guideposts as an essential pillar for price stability.

The Guideposts Restated

1. The general guidepost for wages is that the *annual rate of increase of total employee compensation (wages and fringe benefits) per man-hour worked should equal the national trend rate of increase in output per man-hour.*

2. The general guidepost for prices is that *prices should remain stable in those industries where the increase of productivity equals the national trend; that prices can appropriately rise in those industries where the*

increase of productivity is smaller than the national trend; and that prices should fall in those industries where the increase of productivity exceeds the national trend.

Within a given industry, the guideposts allow for individual wage and price adjustments that do not affect the over-all wage or price level of the industry. Increases for some groups of workers or products can be balanced by reductions for others.

Observance of the guideposts would mean that unit labor costs would decline in the industries where productivity gains are above average, and rise in industries where such gains are below the national average. Average unit labor cost in the economy would remain constant. Similarly, the decrease of prices in industries with above-average increases in productivity would offset the price rises in industries with below-average productivity gains. The average level of prices would remain stable.

Adherence to the standards would mean that *all* the participants in the productive processes—employees and owners of invested capital—would share in the over-all gains in productivity created by the growth of capital equipment, improved technology, and a better educated, healthier, and more skilled labor force. This can readily be seen from a simple example. Suppose output in an industry is 1 million units, each selling at $1, for total sales of $1 million. Suppose labor compensation is $600,000. If productivity and wages both rise 3 percent, and employment remains unchanged, production will expand to 1,030,000 units, which, at $1 a unit would raise revenues to $1,030,000. Labor compensation would rise to $618,000. Labor would thus receive 60 percent of the added value, keeping unchanged the share of labor costs in total revenues. If prices of materials and other purchased inputs were unchanged, and the quantities used were expanded in proportion to output, then gross income of owners would rise in the same proportion as wage income. Thus, the division of income between labor and capital would remain unchanged. And with capital requirements per unit of output unchanged (as has been approximately true), the return per unit of capital would remain unchanged as well.

The actual sharing of gross corporate income between labor and capital has remained virtually unchanged since World War II. There have been repeated short-run swings, with labor's share rising in recession and falling during expansion. Thus, for example, the share of nonwage income rose from 27.8 percent in 1961 to 32.2 percent in 1966. This recent figure is virtually identical with the division of income in 1955 and 1948. The inflationary wage-price spirals of the 1940's and 1950's did not, in fact, change the distribution of income.

Public policy is and should remain neutral with respect to wage and price decisions that attempt to change the distribution of industry's income between labor and capital. But when such decisions lead to inflationary pressure, they properly become a subject of public concern.

- The spurt of demand—partly real, partly psychological—that followed the step-up of our Vietnam effort in mid-1965 simply exceeded the speed limits on the economy's ability to adjust. Our resources were sufficient for the task; but the sheer speed of the advance strained the ability of industrial management to mobilize resources at the required pace.
- Some price advance was the inevitable cost of the adjustments required in recovering from a decade of slack:
  - —Wages had to be raised sharply in underpaid occupations, which previously held their labor only because the alternative was no job at all.
  - —Producers in once stagnant, low-profit industries saw opportunities for expansion and found it possible to raise prices and earnings in order to attract needed capital.
  - —Demand pressed harder on skilled occupations and professional services where we had trained too few persons to meet the needs of a high employment economy.

Some price increases would still have occurred had we moved at a steadier pace.

But these price increases could have come slowly enough and have been small enough not to threaten a chain reaction of wages chasing other wages—wages chasing prices—prices chasing wages—and prices chasing other prices.

It is this spiral we must and can avoid. But it will require responsible action on the part of all.

The Economic Council's Report in 1967 went into great detail to justify the continuation of price-wage guideposts, although not in terms of a specific formula. The Council reviewed the government's experience with the guideposts to date and indicated some of the reasons for less than adequate performance. A policy for 1967 is indicated. This discussion is reviewed in the selections from pp. 119–132, *passim*.

WAGE-PRICE POLICIES

Vigorous competition is essential to price stability in a high employment economy. But competitive forces do not and cannot operate with equal strength in every sector of the economy. In industries where the number of competitors is limited, business firms have a substantial measure of discretion in setting prices. In many sectors of the labor market, unions and managements together have a substantial measure of discretion in setting wages. The responsible exercise of discretionary power over wages and prices can help to maintain general price stability. Its irresponsible use can make full employment and price stability incompatible.

When demand outruns the growth of productive resources, prices and wages will rise even in the most highly competitive markets. (Indeed, they may rise faster and farther than where large firms and long-term labor contracts give some degree of stability.) That kind of "demand-pull"

while others would rise rapidly. That result would clearly be unsatisfactory, for, after a time, workers with similar skills in different industries would be receiving widely different wages.

Alternatively, the yearly percentage increase in hourly wages and fringe benefits in each industry could be the same, equal to the *average* yearly percentage rise in output per man-hour over the whole economy. Then the *average* of unit labor costs in the whole economy would be stable, although rising in some industries and declining in others. If prices in each industry were to change correspondingly, rising in some and falling in others, they, too, would be stable on the *average*. The sharing of gross income between labor and ownership would then be unchanged in each industry, and for the economy as a whole. This is the arithmetic which underlies the Council's 1962 guideposts.

The advance of productivity from year to year is far from uniform, even though its general trend is reasonably clear. The 1962 Report related the guideposts to the trend of productivity over a period of years, rather than to year-to-year changes. This meant that the rise in average hourly wages and fringes should be steady and smooth, not erratic. Moreover, the problem of trying to estimate the particular movement of average productivity over the period to be covered by a given wage agreement was avoided. Consequently, profits would vary with short-run movements in productivity; and the stable distribution of income between labor and ownership would then be achieved only on the average over a period of years. . . .

The Guideposts in Subsequent Council Reports

Reports of the Council since 1962 have preserved the general concepts of wage and price guideposts presented in the 1962 Report. However, the Council has given increasingly clear indications of what it regarded as the trend of productivity which should govern wage movements. In the 1966 Report the Council specifically recommended that the general wage guidepost be 3.2 percent a year.

Most of the exceptions to the general guideposts, both for wages and for prices, that were explicitly stated in the 1962 Report have continued to appear in subsequent Reports. However, the possible applicability of these exceptions has been less emphasized. And the possibility of other, unspecified exceptions has not been mentioned. Moreover, whereas the 1962 Report had emphasized that the guideposts were "guides" not "rules," and were presented as a "basis for discussion," subsequent statements by the Council and others in the Administration have been interpreted as treating the guideposts as firm, though voluntary, rules, and those who fail to adhere to them as "violators."

How the Guidepost Policy Has Worked

In the areas in which the guideposts were expected to apply—among strongly organized groups of workers and in firms which have appreciable

discretion with regard to their prices—the guideposts were reasonably well observed, at least until mid-1966.

Strong labor unions are concentrated in manufacturing, mining, construction, and transportation. Data on the average change in hourly earnings or in total compensation for the total private economy are therefore not particularly helpful in appraising adherence to the wage guidepost.

The most relevant figures are the fragmentary data on important new collective bargaining settlements referred to in Chapter 2. These indicate that until the second half of 1966 the median of such settlements (excluding construction) was only modestly in excess of the general wage guidepost. (However, since many were below the median, there were also some appreciably above.) Construction settlements, on the other hand, consistently and significantly exceeded the general guidepost. Especially in 1966, transportation settlements (for example, airlines and New York subways) were far above the guidepost. Within manufacturing, automobile wages advanced at a rate much above the guidepost, and recent settlements in the electrical equipment manufacturing and telephone industries also were about 1½ percentage points in excess.

Nevertheless, a number of the most significant union settlements—including the key steel bargain of 1965—were at or close to the general guidepost.

It is difficult to generalize about the extent to which the price decisions of firms with price discretion have adhered to the guidepost. It is clear that some significant price reductions which the guidepost would have suggested have not occurred. Automobile prices are doubtless such a case. Steel prices have edged up only moderately, on the average, but it is possible that the guidepost would have permitted some slight increase. The pricing of aluminum—particularly of fabricated aluminum products—could surely not have been consistent with the general guidepost. Producers of steel and aluminum have argued, however, that their relatively low profit positions called for some price increase in order to retain or attract needed capital. Other important price increases about which guidepost questions might be raised include those for newsprint, gasoline, alloy and specialty steels, some chemicals, and agricultural machinery.

For cotton textiles, a sharp decline in the cost of raw cotton would have suggested price reductions; but it can be argued that no individual producer in this highly competitive industry has significant discretion about his prices, and that what happened was a purely supply-demand response. This argument will be tested by what happens to cotton textile prices in the months ahead. Prices of machine tools and of many other types of industrial equipment have undoubtedly risen substantially faster than costs. However, in view of the excess demand for this category of goods, it seems clear that producers have practiced restraint, and that—in a purely competitive market—prices would have risen faster and farther.

In the minerals industries, increases in sulphur and the small increase in copper (until January 1967) again are cases in which price restraint has clearly held prices below levels which would clear the market, even though a pure guidepost policy might not have implied any price increase. Moreover, in these cases, the possible need for higher prices to encourage the use and development of marginal resources complicates any judgment of the public interest in these prices.

In general terms, the greatest failure of observance of the price guidepost lies in the failure to reduce prices on a considerable number of the product lines of a large number of industries. As Chapter 3 has indicated, a number of the price increases that have occurred in manufacturing and mining industries undoubtedly had some justification in higher costs. But offsetting price decreases have been far too few. . . .

Basic Problems for Wage-Price Policy in 1967

Two important developments have created the major problems for wage-price policy today. The first is that consumer prices have risen by 3.3 percent in the past 12 months, which makes organized workers—even in unions which were previously disposed to cooperate with the Government's policy—unwilling to contemplate settlements at or close to the guideposts. And it gives unions which were never disposed to cooperate an additional reason for not doing so. The second development is that corporate profits have increased considerably more than aggregate labor income, especially when measured from the slack years of the late 1950's or the recession year of 1961. This provides a second reason for labor's resistance to the guidepost.

There can be no question that some part of the rise in consumer prices is due to past failure to observe the guideposts, both by organized labor and by business. And some part of the faster rise of corporate profits has been due to the failure of some businesses to make their price decisions conform to the guidepost principles (particularly by not reducing some prices when costs fell).

But it is clear from Chapter 2 that the primary source of the rise in consumer prices lies in areas to which the guideposts have no applicability: in farm products, where prices have risen considerably, despite rapid productivity gains; and in services, where wages and professional incomes of unorganized workers have also risen rapidly.

So far as the rise in corporate profits is concerned, much of it would have occurred had the guideposts been precisely followed. As noted above, the year-to-year advance of productivity frequently diverges from the long-term trend during years of rapid expansion, and did from 1962 at least through 1965. Moreover, greater sales volume and higher operating rates meant lower unit capital costs, thus adding to profits. Consequently, even if guidepost principles on wages and prices had been literally observed, profit margins during such a period would have increased sharply, and aggregate profits even more so. Likewise, the leveling

off of profits in 1966—when productivity gains slowed down—is consistent with the guidepost expectation.

Nevertheless, the rise in consumer prices and the increasing share of profits until the first quarter of 1966 are facts that cannot be disputed nor explained out of existence. And they cannot fail to influence the behavior of wages in 1967. Through the effect of wages on costs, they will also influence prices.

A Wage-Price Policy for 1967

The main issues for wage-price policy in 1967 are these:

(*a*) Should the guidepost for wages be adjusted to recognize in some way the recent increase in living costs?

(*b*) Should further recognition be given to special factors—other than those previously recognized—which appropriately justify exceptions to the general guidepost principles?

(*c*) To what extent should profit margins absorb cost increases?

Recognition of Higher Living Costs

The Council recognizes that the recent rise in living costs makes it unlikely that most collective bargaining settlements in 1967 will fully conform to the trend increase of productivity. But it sees no useful purpose to be served by suggesting some higher standard for wage increases, even on a temporary basis.

The only valid and noninflationary standard for wage advances is the productivity principle. If price stability is eventually to be restored and maintained in a high-employment U.S. economy, wage settlements must once again conform to that standard.

While it can be expected that many wage settlements in 1967 will exceed the trend increase of productivity, it is obvious that if, on the average, they should exceed it by the amount of the recent increase in living costs, price stability could never be restored. If the average wage increase in 1967 were to include a full allowance for productivity plus an additional margin to "compensate" for past increases in living costs, unit labor costs would rise at a rate which would require living costs to continue their rapid rise.

In this connection, it must be recognized that some part of the advance of consumer prices represents a transfer of income to public uses. Most State and local governments are compelled repeatedly to raise indirect tax rates to finance the expansion of essential services. These indirect taxes enter into prices, accounting for 0.2 percentage point of rise in the consumer price index in 1966. And in 1967, there will be no offset to the rise in these indirect taxes (as in 1965 and 1966) from reduced Federal excises. If every group attempted to offset the burden of these higher indirect taxes by a compensating rise in money incomes, no transfer of real resources to public purposes could be achieved.

It is not expected that market forces in 1967 will again require that

average wages in the largely unorganized sectors—agriculture, trade, and services—should rise faster than in the organized segments—manufacturing, mining, construction, and transportation—in order to promote an efficient allocation and use of labor. But the higher minimum wage effective in 1967 will have its principal impact on wages in the unorganized sectors, and in the largely unorganized low-wage segments of manufacturing. Thus there will be some continued pressure on costs and prices originating in wage increases outside of the organized sectors.

In 1967, the national interest continues to require restraint in wage settlements; indeed, it is more essential than ever that restraint be practiced in order to turn the trend of prices back toward stability. If restraint cannot mean an average wage advance only equal to the rise in productivity, it surely must mean wage advances which are substantially less than the productivity trend plus the recent rise in consumer prices.

Although the Council recognizes that some allowance will frequently be made for higher living costs in 1967 settlements, it continues to believe that arrangements which automatically tie wage rates to changes in consumer price indexes will contribute to inflation. One union may be able to protect its members in this way against any deterioration in its real wage or any real impact from increased indirect taxes. But it does so only by imposing more of the burden on others. And if all unions—and other groups in society—were to succeed in tying compensation to consumer prices, the arrangement would become a vast engine of inflation, which, once it began to roll, would continue to gain speed.

Guidepost Exceptions

The most frequent criticism of the present wage guidepost—after the criticism that it fails to allow for the rise in consumer prices—is that it fails to provide sufficient exceptions for the many special and individual circumstances of which account must be taken in wage negotiations. This criticism requires consideration.

A guidepost exception has always been made for low wages. In a year in which the minimum wage will advance 11 percent, from $1.25 to $1.40 an hour, with an inevitable impact on wages previously near the new minimum, this exception is obviously significant. The fact, however, that few strong unions exist among low-wage workers gives the exception only limited relevance for collective bargaining.

It surely does not justify large wage increases for high-wage unions. Indeed, the productivity arithmetic suggests that, if an exception for low-wage workers is to be meaningful in permitting low-wage workers to receive increases in *real* wages, high-wage workers who have profited in the past from exceptionally strong bargaining power must respect the counterpart exception that their wage increases should be less than the average.

Second, the guidepost principle has always contained a clear exception for wage changes that serve an economic function by assisting in the re-

allocation of labor toward shortage occupations and industries. Thus, for example, no complaint has ever been made in the name of the guideposts with respect to the large wage increases recently received by nurses.

Indeed, in a high-employment economy, the importance of differential wage changes as an instrument of labor reallocation is greatly increased, and, this exception is more important today than in earlier years. However, the Council suggests that, as a general principle, an exception to the guideposts for workers in a shortage occupation should be claimed only where the union involved stands ready to lift every artificial barrier to entry into the occupation, and to cooperate fully in public and private efforts to train whatever numbers of workers may desire to enter the occupation. Moreover, as indicated in Chapter 2, the remaining labor shortages this year will be concentrated in unorganized professional and technical occupations.

Other exceptions have frequently been proposed for incorporation in a national wage policy.

One such proposal is to allow for the narrowing of differentials between wage rates paid in different industries or by different employers for similar work—the so-called issue of "comparable wages." To the extent that such differentials may interfere with a rational allocation of labor, their correction is already encouraged by the exception just discussed.

The public interest obviously requires that wage settlements pay appropriate attention to factors of comparability. But it cannot accept inflationary settlements every time this justification is alleged.

At least within a single labor market area, it is surely desirable that workers in occupations requiring similar training, skill, education, and responsibility should be paid the same wage. This is less obviously as between labor markets. Even within labor markets, some wage differentials may reflect the fact that one employer finds it worthwhile to pay above-average rates in order to insure low turnover, good morale, and greater selectivity in hiring, while another prefers to pay lower rates and forego these advantages.

It is probably true, on the whole, that the dispersion of wages for similar work by similar workers is larger than it should be from the point of view of either efficiency or equity. But the wage comparisons made in collective bargaining disputes often have little or no relevance either to resource allocation or to equity. Very often the wage comparisons in collective bargaining are only part of a game of follow-the-leader which, at best, is irrelevant to resource allocation and, at worst, speeds up a wage-price spiral.

Many recent instances in which outsized wage agreements have emerged from collective bargaining—based on claims that such increases were necessary in order to achieve wage comparability—have created more problems of inequity and inefficiency than they have resolved. Meaningful wage comparisons should be made out not only with wages that are higher but also with those that are lower. Otherwise, wage increases to

achieve "comparibility" may actually reduce it. Unions can always find *some* group of workers more highly paid than they—whether or not all other conditions are similar. If all corrections of such "inequities" are upward, labor cost inflation is inevitable.

One recent important collective bargaining dispute produced a highly inflationary union form percentage increase for the entire work force involved. The justification was that an increase of this magnitude was necessary to correct what may have been genuine disparity between the wages of a small group of specialized workers and similar workers in other employments. The mediation committee which recommended the settlement recognized that, for the great majority of the work force involved, wage rates were already as high as or, higher than those for comparable workers. But they could not recommend destroying the customary relationship between the wages of those workers for whom the disparity was found to exist and the wages of all other members of the work force. This is a clear recipe for inflation.

Another exception frequently urged is that, in industries with rapid productivity gains, wages should rise faster than the average. If such an exception were made, it would necessarily impart an inflationary bias to the system—for no one argues that wages will or should rise less rapidly or not at all in industries with little or no productivity gain.

It is clearly in the public interest for unit labor costs and prices to fall in industries with relatively high productivity gains. In the long run, falling unit labor costs do result in falling prices (except where there are offsetting increases in other costs). But the long run may be too long for labor's and the public's patience. And sometimes the very factors that produce falling costs may work against price reduction. For example, the industries in which labor costs are falling are often those in which demand, and thus production, is expanding most rapidly—a situation which weakens rather than strengthens the competitive forces driving down prices. . . .

PRICE POLICY FOR 1967

The foregoing discussion has indicated the essential character of the problems which businesses with pricing discretion will face in 1967:

(1) Wage contracts newly negotiated in 1967 will tend to raise the unit labor costs of many firms and industries.

(2) Nevertheless, many important industries will continue to operate in 1967 under labor contracts negotiated in 1965 or 1966, which often will be consistent with declining unit labor costs.

(3) Although the cost of purchased industrial products may frequently be higher in 1967 than in 1966, the purchase cost of some raw materials will be lower.

8. POLICIES FOR ECONOMIC GROWTH

Most economists in both the free and the controlled societies agree that economic growth is a highly desirable national economic objective. Disagreement, however, appears over the meaning of growth, what should be the desired growth rate, and how best to achieve the growth objectives. All of the Economic Reports have been concerned with growth since the Employment Act emphasized the importance of a growing and dynamic economy.

Analysis of Economic Growth, Economic Report of 1960

The 1960 Report began with an analysis of economic growth, depicting the responsibility of various sectors for growth. We reproduce part of that statement below (pp. 1–8). The mutual responsibilities of the private sector and government are described.

ECONOMIC GROWTH IN A FREE SOCIETY

The vigor of the underlying forces that make for growth in the American economy was clearly evident in 1959. Employment, production, and income at the end of the year were substantially above the levels reached at the end of 1958, despite the prolonged strike in the steel industry. As this Economic Report is transmitted to the Congress, the outlook is good for an extension of growth through 1960 and beyond.

In these circumstances, it is appropriate that the first chapter of this Report should be addressed to the question of how best to extend economic growth into the years ahead at a high and sustainable rate and in ways that strengthen and reinforce our political and economic freedoms. Other chapters of the Report summarize the leading economic developments in 1959; describe the policies that were pursued in the past year to promote higher employment, production, and purchasing power; and set forth the Administration's 1960 program for extending the Nation's economic progress.

Record of Growth in the American Economy

A few facts illustrate the ability of the American economy to continue raising what has been the highest living scale in the world, while carrying a heavy defense burden and meeting broad international obligations.

In the 14 years since the passage of the Employment Act, employment has advanced, on the average, by nearly 800,000 a year. In real terms, the Nation's output of goods and services, as well as its personal income, has increased by more than 50 percent, or at a rate of 3.2 percent per year; and the output of the private sector of the economy has advanced at a slightly higher rate, 3.5 percent. For industrial production, the rate of increase has been 4.5 percent. The annual increase of 3.2 percent in total national output, which corresponds to a doubling every 22 years, is roughly equivalent to the long-term average reached in our previous history. Thus, the American economy has sustained its long-term record of growth, despite the high level of industrial development already achieved and despite temporary setbacks.

The increase in national output has made possible very great gains in the well-being of American families. Evidence of the advances made in this respect since passage of the Employment Act is presented in the Appendix on "Diffusion of Well-Being" included in this Report. Real income per capita has increased by nearly 20 percent since 1946, and the increase per family has been 16 percent. As incomes have risen and as paid vacations have become longer and more common, leisure time has increased and recreational activities have become more widely enjoyed. The shortage of housing so evident immediately after World War II has been virtually eliminated. Since 1946, the housing supply has been increased by the construction of 15 million private nonfarm dwelling units, and there have been marked improvements in the quality of housing. At the same time, there has been a general increase in home ownership; some 60 percent of all nonfarm dwelling units are owned by the occupant families.

Attention to such material advances should not obscure the accompanying gains made with respect to other components of our well-being, some of which are less tangible. In health, there has been remarkable progress in the reduction of infant and maternal mortality, in the prevention, mitigation, and treatment of many diseases, in restoring the physically handicapped, in making available a better balanced diet at lower cost, and in creating other conditions conducive to longer years of life and greater efficiency. Health services are more and more widely available, and the great majority of Americans now have some protection under voluntary plans of hospital, surgical, and medical insurance.

Notable gains have been made in education and other cultural areas. School enrollment has risen in the last 12 years from 50 percent to about 65 percent of all persons in the age group of 5 to 29 years. From 1946 to 1959, the number of Bachelor's and first professional degrees conferred annually almost trebled, and the number of Master's and second professional degrees showed a still greater relative increase. To some extent, these advances represent the resumption of academic work interrupted by war, but the large gains made in the past few years indicate a rising trend that will accelerate in the years ahead. The number of earned Doc-

torates conferred rose sharply after the war, reaching in 1954 a new high, which has been maintained for several years. In the past decade, more than 83,000 Doctorates have been conferred, compared with some 27,000 during the 1930's and about 31,000 in the 1940's. Marked increases are expected also in the next several years. Another source of satisfaction is the record of scientific achievement. Since 1946, close to half of the Nobel awards for contributions to medicine, chemistry, and physics have been bestowed on American citizens.

The economic security of American families has been advanced significantly in the years since World War II. About 58 million persons—87 percent of all those in paid employment—are now covered by the Federal Government's old-age, survivors, and disability insurance system and related programs. More than 19 million persons are covered by privately financed pension plans. The Federal-State Unemployment Compensation System, which has proved its worth as a defense against loss of income during periods of economic adversity, now provides protection for nearly 85 percent of all persons on nonfarm payrolls.

But the progress made under Government programs should not divert attention from the extensive provisions made independently by Americans for personal and family security. The number of life insurance policyholders, for example, has increased by about 60 percent since 1946; about 115 million persons were insured through legal reserve companies in 1959. The volume of time and savings deposits of individuals has increased by nearly $35 billion, or more than 50 percent, since 1952. Share accounts in savings and loan associations have also risen by $35 billion in this period—by nearly 200 percent.

And it is not too much to say that we have made good progress in moderating fluctuations in our economy. Although economic recessions, however minor, must remain a matter of concern to all Americans, the relative mildness and short duration of the three since the war have to be reckoned as a major factor in the strengthening of personal security. . . .

Shared Responsibility for Economic Growth and Improvement

The economic tasks of the next decade pose impressive challenges, but there is every reason to believe that they will be met, just as similar challenges have been met in the past. We should regard these challenges as opportunities, and recognize that we have great advantages as we go about meeting them. A large productive base already exists in the American economy, and our competitive enterprise system is well able to expand this base as needs increase. The ideals, freedoms, incentives, and rewards of our enterprise society are powerful forces in directing efforts and material resources to the meeting of new tests. And our traditional and proven system of sharing responsibility for economic growth and improvement between the private and public sphers of our society, and among the several levels of government, provides a means for guiding those efforts along fruitful lines.

The premises of this system of shared responsibility, recognized by the Congress in Section 2 of the Employment Act, deserve renewed emphasis as we prepare for the challenges and opportunities of the new decade. In our society, the maintenance of a climate conducive to orderly and vigorous economic growth is not exclusively the function of government. Indeed, excessive reliance on governmental machinery may not only frustrate the quest for steady growth and reasonably stable prices, but may also have undesirable consequences for our economic system and our freedoms. The more effective the job done by individuals and private groups and by government at the State and community levels, the less the danger of Federal encroachment in areas that have traditionally been the province of private enterprise and of local government. Our various levels of government and private individuals and groups have distinctive roles in our free society's system of shared responsibility. At this point it is well to recall these roles, with particular reference to the problem of maintaining a high rate of economic growth.

Roles of Government

In a free society, government makes its major contribution to economic growth by fostering conditions that encourage and reinforce the efforts of individuals and private groups to improve their circumstances. This includes the preservation and enhancement of competition, the maintenance of a stable currency, the moderation of fluctuations in employment and output, participation in the development of human and natural resources, the enhancement of personal security, provision of a sound national defense, and the maintenance of mutually advantageous ties with other countries.

Responsibility for many of these roles is divided among the various levels of government, but none can be carried out adequately without the initiative and cooperation of individuals and private groups. This network of relationships is the product of our history. It embodies the American concept of government as the responsive instrument of the people.

The Federal Government's contribution toward preserving and strengthening the institutions of our competitive enterprise system, to which the Employment Act properly directs attention, is of special importance. Open markets perform the essential task of channeling economic resources into the uses that businessmen and consumers deem most satisfactory; in this way, they contribute to the productiveness of our economy and to the quality of our living. They should remain free of unwarranted restraints. Leaders of business, labor, farming, and the professions, as well as the various levels of government, have responsibilities for maintaining the openness and resiliency of our economic system. The competitive nature of this system is closely linked to our ideals of freedom and individual initiative, which have far more than economic significance. A free society, free political institutions, and a free economy are interdependent and reinforce each other.

As indicated earlier, Federal action to help smooth out economic

fluctuations affords another opportunity to promote growth. Deep and prolonged declines of production, involving substantial reductions in investment, not only interrupt current advance but impede future growth. It is widely acknowledged that to avoid such declines Government should take measures, appropriately designed and timed, to counter recessionary tendencies. It is also important that appropriate measures should be taken to restrain surges in economic activity that might lead to drastic corrections.

Governmental decisions regarding the volume and character of public expenditures have powerful effects on the health of the economy and on its prospects for vigorous and sustainable growth. Especially in a briskly growing economy—the kind to be expected in the current decade—demands on economic resources are heavy and rising, and public outlays are made at the expense of private spending. The public use of funds, whether to continue established programs or to initiate new ones, must be justified on the ground that it makes a larger contribution to well-being and economic strength than could be made by their private use. The entire range of Federal spending must be continuously under review, with this criterion in mind. Many public programs make important contributions to growth, both directly by increasing the productive capacity of individuals and business firms and indirectly by facilitating and encouraging the greater private investment that enlarges our capacity for future production. It must always be borne in mind, however, that we grow only by investing more and producing more, not simply by spending more.

The way taxes are levied also affects the advance of productivity and output. We must remain alert to the possibility of making the tax system a more effective instrument for promoting economic growth. Taxes affect the ability of individuals and corporations to save. Likewise, their impact on the risk and return of investment influences the willingness to make productive use of savings. Our tax system should give encouragement to productive effort and should facilitate the mobility and efficient use of capital. We should continue to review our tax system from these standpoints, as well as from the standpoint of equity.

The Federal Government can make a basic contribution to an environment favorable to economic growth through a constructive, forward-looking management of its finances. To meet this vital responsibility in fiscal affairs, while performing its functions adequately, Government must give clear evidence, in actual results, of its ability and determination to control its expenditures. When the Nation is prosperous, as it is today, with production, employment, and incomes rising, the most appropriate fiscal policy is one that provides a sizable excess of Federal revenues over Federal expenditures. In the economic circumstances now prevailing and expected in the near future, a budgetary surplus used to retire debt would be a powerful aid in helping to restrain inflationary pressures and to promote sound growth. The added savings which it would supply to the

economy would help keep interest rates lower than otherwise, and facilitate private investment activity and the financing of public projects by State and local governments. The monetary authorities would have a freer hand in pursuing policies aimed at promoting steady, inflation-free growth. And such a fiscal policy would be a potent instrument for strengthening confidence in the dollar at home and abroad. Indeed, a sizable budget surplus at this time, used to retire Federal debt, would effectively implement the objectives proclaimed in the Employment Act.

Roles of Individuals and Private Groups

Since the vast majority of economic decisions in a free society are made by private individuals and groups, the rate at which national output grows and the character of that output are determined chiefly by private attitudes and actions. The expenditures of consumers command about two-thirds of the Nation's total product, and private investment expenditures command another one-eighth, or more. Individuals and business concerns supply the bulk of the Nation's savings, and the major responsibility for directing these savings into private and public investment rests with private institutions. Finally, as citizens of a democracy, individuals determine directly or through chosen representatives what they want done through government, and at what cost. Obviously, the performance of our free economy depends largely on how individuals and private groups fulfill their many critical roles.

In their key role as consumers, individuals can contribute to the Nation's economic strength by spending wisely, just as government, acting as their agent, can promote growth by prudence in its spending. By the use to which they put their income they determine in large measure how economic resources are allocated. And in buying carefully for price and quality, they exert a restraining influence on the cost of living.

Individuals and corporate groups, in their roles as business leaders, can help strengthen the economy by the use they make of the resources under their control. They may be able to speed the increase in productivity in the private sector through allocating a greater share of these resources to investment and research and through pricing policies that favor the expansion of markets. Also, they can speed growth by upgrading worker skills, by improving the skills of management, and by eliminating wasteful practices.

Equally, leaders of labor have an opportunity as well as a responsibility to help realize more fully the Nation's economic potential. They can contribute significantly in this direction by fostering arrangements favorable to higher labor productivity.

And leaders of business and labor have a joint responsibility for facilitating economic growth through the conduct and results of collective bargaining. This responsibility is especially great in industries that are basic to the Nation's defenses and economic health. Events of the past

year demonstrate the damage that can be done when established methods for settling industrial disputes break down. An obvious way to achieve our economic potential more fully is to improve on this aspect of the past year's record. Labor-management disputes in basic industries should be settled promptly, preferably without recourse to strikes, and certainly without extended interruptions of production that cause widespread dislocation and unemployment and threaten to paralyze our entire economy. They should be settled also on terms that are fair to the public at large as well as to the parties directly involved.

Labor-management negotiations in all industries offer opportunities to help promote sound growth by avoiding settlements that contribute to inflation. Settlements should not be such as to cause the national average of wage rate increases to exceed sustainable rates of improvement in national productivity. A national wage pattern that fails to meet this criterion would put an upward pressure on the price level. Hourly rates of pay and related labor benefits can, of course, be increased without jeopardizing price stability. Indeed, such increases are the major means in our free economy by which labor shares in the fruits of industrial progress. But improvements in compensation rates must, on the average, remain within the limits of general productivity gains if reasonable stability of prices is to be achieved and maintained. Furthermore, price reductions warranted by especially rapid productivity gains must be a normal and frequent feature of our economy. Without such reductions we shall not be able to keep the price level as a whole from advancing. . . .

Request of President Kennedy, Economic Report of 1962

The 1962 Report called attention to the fact that the record of economic growth in the United States since 1947 was marked by four recessions. Accordingly, President Kennedy asked for a three-part program designed to give him standby powers to combat future recessions and to sustain the path of economic growth. This request (p. 4) is stated as follows:

To combat future recessions—to keep them short and shallow if they occur—I urge adoption of a three-part program for sustained prosperity, which will (1) provide stand-by power, subject to congressional veto, for temporary income tax reductions, (2) set up a stand-by program of public capital improvements, and (3) strengthen the unemployment insurance system.

These three measures will enable the Government to counter swings in business activity more promptly and more powerfully than ever before. They will give new and concrete meaning to the declaration of policy made in the Employment Act. They will constitute the greatest step forward in public policy for economic stability since the Act itself.

The Report then went on to present a program for sustained growth and prosperity, as follows (pp. 17–19):

. . .

MEASURES FOR A STRONGER ECONOMY

. . .

A Program for Sustained Prosperity

Recurrent recessions have thrown the postwar American economy off stride at a time when the economies of other major industrial countries have moved steadily ahead. To improve our future performance I urge the Congress to join with me in erecting a defense-in-depth against future recessions. The basic elements of this defense are (1) Presidential stand-by authority for prompt, temporary income tax reductions, (2) Presidential stand-by authority for capital improvements expenditures, and (3) a permanent strengthening of the unemployment compensation system. These three measures parallel important proposals of the Commission on Money and Credit, whose further recommendations are treated under the next heading.

In our free enterprise economy, fluctuations in business and consumer spending will, of course, always occur. But this need not doom us to an alternation of lean years and fat. The business cycle does not have the inevitability of the calendar. The Government can time its fiscal transactions to offset and to dampen fluctuations in the private economy. Our fiscal system and budget policy already contribute to economic stability, to a much greater degree than before the war. But the time is ripe, and the need apparent, to equip the Government to act more promptly, more flexibly, and more forcefully to stabilize the economy—to carry out more effectively its charge under the Employment Act.

Stand-by tax reduction authority. First, I recommend the enactment of stand-by authority under which the President, subject to veto by the Congress, could make prompt temporary reductions in the rates of the individual income tax to combat recessions, as follows:

(1) Before proposing a temporary tax reduction, the President must make a finding that such action is required to meet the objectives of the Employment Act.

(2) Upon such finding, the President would submit to Congress a proposed temporary uniform reduction in all individual income tax rates. The proposed temporary rates may not be more than 5 percentage points lower than the rates permanently established by the Congress.

(3) This change would take effect 30 days after submission, unless rejected by a joint resolution of the Congress.

(4) It would remain in effect for 6 months, subject to revision or

renewal by the same process or extension by a joint resolution of the Congress.

(5) If the Congress were not in session, a Presidentially proposed tax adjustment would automatically take effect but would terminate 30 days after the Congress reconvened. Extension would require a new proposal by the President, which would be subject to congressional veto.

A temporary reduction of individual income tax rates across the board can be a powerful safeguard against recession. It would reduce the annual rate of tax collections by $2 billion per percentage point, or a maximum of $10 billion—$1 billion per point, or a $5-billion maximum, for six months—at present levels of income. These figures should be measured against the costs they are designed to forestall:

—the tens of billions of potential output that run to waste in recession;

—the pain and frustration of the millions whom recessions throw out of work;

—the Budget deficits of $12.4 billion in fiscal 1959 or $7.0 billion this year.

The proposed partial tax suspension would launch a prompt counterattack on the cumulative forces of recession. It would be reflected immediately in lower withholding deductions and higher take-home pay for millions of Americans. Markets for consumer goods and services would promptly feel the stimulative influence of the tax suspension.

It would offer strong support to the economy for a timely interval, while preserving the revenue-raising powers of our tax system in prosperity and the wise traditional procedures of the Congress for making permanent revisions and reforms in the system. I am not asking the Congress to delegate its power to levy taxes, but to authorize a temporary and emergency suspension of taxes by the President—subject to the checkrein of Congressional veto—in situations where time is of the essence. . . .

Report of the Economic Council, 1962

The Council's 1962 Report also examined economic growth and indicated some of the problems associated with an accelerated growth rate (pp. 108–110).

ECONOMIC GROWTH

Faster economic growth in the United States requires, above all, an expansion of demand, to take up existing slack and to match future increases in capacity. Unless demand is adequate to buy potential output, accelerating the growth of potential is neither an urgent problem nor a promising possibility. Full utilization will itself contribute to growth of capacity. Saving and investment to increase capacity and improve productivity flourish in prosperity and wane when the economy is slack. Reduction of economic fluctuations lessens the risks associated with inno-

vation and investment and diminishes the resistance to technological change. A full employment economy can achieve more rapid growth than an economy alternating between boom and recession; for that reason, effective stabilization policy is the first step toward a policy for economic growth. But stabilization policy is not enough. A sustained improvement in the growth rate requires also a concerted effort, private and public, to speed the increase of potential output. Chapter 1 has analyzed the current problem of underutilization. In this chapter the emphasis is on the growth of potential output.

The growth of the U.S. economy results primarily from decisions taken by individuals, families, and firms. However, all levels of government—Federal, State and local—have a role in the promotion of economic growth. It is no part of that role to force on unwilling households and business firms any particular rate of growth in their own individual activities. But if, as a Nation, we desire a higher rate of growth, there are two consequences for government policy. First, in those areas of economic activity traditionally allotted to some level of government, public expenditures must provide services which contribute to the growth of potential output and which satisfy the needs that accompany increasing income and wealth. Second, public policy—notably in the fields of taxation, education, training, welfare, and the control of money and credit—inevitably stimulates or retards the growth potential of the private economy, even if no such result is consciously intended. Accelerated economic growth requires coordinated policy at all levels of government to facilitate the increase of productivity and the expansion of capacity. No change is implied in the historic division of responsibility between public bodies and private citizens.

Growth: Problem or Opportunity

The sources of growth of potential output often present themselves as "problems." A rapidly expanding labor force provides new workers to man factories and perform services, and opens new opportunities for investment to equip them. But it accentuates simultaneously the "problem" of assuring useful jobs at satisfactory wages for an ever-growing number of job seekers. Rapid technological progress increases productivity, releasing labor and other resources for new uses. But it creates simultaneously the "problem" of displaced workers, declining industries, and depressed areas. The problems and the opportunities are opposite sides of the same coin. A commitment to accelerated growth is at the same time a commitment to solve even more such problems. The challenge is to find solutions which do not limit the economy's capacity to grow.

This is what is meant by saying that there are "growing pains" associated with economic progress. They are not new. Nor are they insoluble if the expansion of demand creates new opportunities for labor and capital as old ones disappear. An adequate level of demand, though not itself the solution to structural problems, is a necessary precondition to the solution.

The most pressing of the social problems resulting from rapid industrial progress is the creation of islands of obsolete capacity and unwanted skills. It is inequitable to inflict the costs of progress on an arbitrarily selected few, when the benefits are widely shared. It is more than inequitable—it is self-defeating—to invite resistance to progress, pools of idleness, low productivity, and poverty. The need for specific policies to restore the earning power of displaced workers and the vitality of depressed regions has already been emphasized in connection with the objectives of the Employment Act itself. That need is intensified with the acceptance of accelerated economic growth as a goal of national policy.

Faster economic growth incurs costs and imposes responsibilities. It must—if it is worth undertaking—confer even larger benefits. Potential output has been growing, on the average, at 2.9 percent annually since the turn of the century and at about 4 percent since the end of the second World War, though since 1954 the rate has slowed to 3.5 percent. Yet there are sound reasons for wanting even faster growth in the future—(1) unsatisfied needs at home and (2) threats to freedom abroad.

(1) Per capita disposable personal income, measured in 1961 dollars, has been increasing since 1947 at about 2 percent a year; it surpassed $2,000 a year in the last quarter of 1961. Nevertheless, about 30 percent of all families and unrelated persons have less than $1,000 of money income per person, and are now below the level that the average American achieved a quarter-century ago.

A high rate of economic growth today will enable increasing millions to enjoy better lives tomorrow. Only a limited imagination can fail to see opportunities for providing more fully both such basic needs as food, clothing, and shelter and the amenities of civilized life—education, medical care, travel and recreation.

In many, though not all, contexts growth in per capita production will reduce the number of persons with low incomes. Poverty in the United States is disproportionately concentrated among the aged, the nonwhite, the poorly educated, marginal farmers, and families without a male breadwinner. The disadvantaged fare better in a buoyantly growing economy. But for some, the remedy lies in welfare or insurance payments coupled with substantially improved services and retraining to restore them to self-sufficiency. In the longer run, the provision of good education and adequate health services for the children of these families is essential to break the degrading cycle of dependency.

Other unfilled needs lie in the field of public or mixed public and private expenditures. The renewal of cities, the reconstruction of transportation of facilities, the improvement of education at all levels, the provision of new facilities for the arts, the expansion of medical care facilities, the conservation and expansion of our national parks and forests, all these things need more resources than we now devote to them. Economic growth will help create those resources.

(2) The leadership of the free world imposes heavy economic burdens on the United States. The primary responsibility for maintaining the military security of the free world falls on us. Although we hope that world tensions will slacken, we must be prepared if they do not. If the threat rises in intensity, we must increase our defense capabilities to meet that threat. The future needs of defense are uncertain but imperative; the larger and more efficient our economy, the more readily will we be able to shoulder larger military burdens, if we must.

Our responsibility is no less in the global battle against poverty, ignorance, and disease. The less developed nations need our capital and technique. They also need a further demonstration of the ability of a free economy to grow, to prosper, and to use its enhanced resources wisely.

The foreign trade policy of the United States should be formulated with regard for the obvious fact that a more satisfactory rate of economic growth can be achieved here and abroad if producers are stimulated to efficiency by active participation in international trade. A liberal trade policy works to this end by providing increased market opportunities abroad for U.S. products while promoting the efficient utilization of resources through the invigorating effects of foreign competition, whether encountered in our home markets or in the markets of other countries. . . .

In recent years, increasing attention has been given to the investment in human resources as being as significant for promoting growth as is investment in physical resources. The Council discussed this point in its 1962 Report (pp. 117–118).

Investment in Human Resources

Increased production is not an end in itself but only a means of providing increased real income for all to share. As indicated earlier, this is one of the reasons that more rapid growth is a desirable social goal. High levels of education and health, equality of opportunity—these are among the valid measures of a society's performance. They are desirable in their own right. In addition, they have an economic dimension. They are among the foundations of growth as well as among its benefits.

Americans have long spoken of foregoing consumption today in order to invest in their children's education and thus in a better tomorrow. For an economy, just as for an individual, the use of the word *invest* in this connection is clearly justified, since it is precisely the sacrifice of consumption in the present to make possible a more abundant future that constitutes the common characteristic of all forms of investment. That devoting resources to education and health is, in part, an act of investment in human capital explains why programs in the area of education and health are economic growth programs. This kind of investment has a long and remarkable history. Rough estimates, which take into account differences in the length of the school year and in

to move ahead on other programs to strengthen the underlying sources of the Nation's capacity to grow. No one doubts that the foundations of America's economic greatness lie in the education, skill, and adaptability of our population and in our advanced and advancing industrial technology. Deep-seated foundations cannot be renewed and extended overnight. But neither is the achievement of national economic purpose just a task for today or tomorrow, or this year or next. Unless we move now to reinforce the human and material base for growth, we will pay the price in slower growth later in this decade and in the next. And so we must begin. . . .

Stepping up the U.S. growth rate will not be easy. We no longer have a large agricultural population to transfer to industry. We do not have the opportunity to capitalize on a generation's worth of advanced technology developed elsewhere. The only easy growth available to us is the growth that will flow from success in ending the period of sluggishness dating back to 1957. That we must have if only because it is inexcusable to have the American economy operating in low gear in a time of crisis.

Beyond full employment, however, we must rely on the basic sources of all long-run growth: people, machines and knowledge. We must identify and use a variety of ways—some imaginative, some routine—to enable our people to realize the full promise of our technology and our economy. In a setting of full employment, these measures can help to move our growth rate to 4 percent and above, the American people toward greater abundance, and the free world toward greater security.

Recommendations of the Economic Council, 1963

The Council also presented a set of recommendations to foster economic growth (pp. 60–61).

Starting from our present position of underutilization, it has been estimated that we can achieve an increase of about six-tenths of a percentage point in our average annual growth rate for the 1960's by reducing our unemployment rate to 4 percent with the concomitant increase in utilization of capital facilities. This rise in the growth rate comes as a bonus to successful employment policy. Once underutilization of productive capacity has been eliminated, our rate of growth will depend upon the pace at which productive capacity itself expands. Growth of productive capacity in turn is the sum of (a) the percentage rate of growth of the labor force adjusted for changes in the average workweek, and (b) the percentage rate of increase in productivity per man-hour. Public policy can accelerate growth of productivity mainly by stepping up the pace of our efforts to:

—improve the education, health, occupational skills, motivations, and attitudes of the labor force;

—build up the stock of private producers' plant and equipment, and improve its composition by age, type, and location;

—increase the stock of public physical capital, including roads, water systems, school buildings, and hospitals;
—improve the terms on which the economy has access to natural resources, whether through domestic production or imports;
—advance the level of technology, covering the range from managerial and organizational competence to scientific and engineering understanding;
—raise the efficiency with which capital, resources, technology, and labor are used;
—improve communications systems so as to accelerate the dissemination of information on technological, commercial, and employment opportunities.

Report of the Economic Council, 1964

Technology and technological changes as factors contributing to economic growth were emphasized by the Council in its 1964 Report (pp. 85–87).

THE PROMISE AND PROBLEMS OF TECHNOLOGICAL CHANGE

One lesson of man's history is unmistakable: the crucial element in the rise in our material well-being has been the progressive utilization of our ever-growing store of knowledge of the world in which we live. From the wheel to the electronic computer, new discoveries have been put to work for man's benefit—benefit that has taken the form of shorter hours of work, the elimination of backbreaking toil, a continuing stream of new goods and services, and a total output per capita that has risen 5-fold in the United States since the Civil War.

While technological change is as old as man, its character and pace, and therefore its impact, have changed in recent centuries. The modern economic history of the industrial nations constitutes a decisive break with all of prior history. For thousands of years, a man followed the path of his father and grandfather before him, doing the same things in essentially the same way. Major technological changes came infrequently, and their adoption was spread over many centuries. The whole structure of modern society, however, is geared to innovations—those who initiate or adapt to change are rewarded, those who do not or cannot are penalized. The businessman who refuses to adopt new technology will not merely see his profits stand still; they will surely dwindle and turn into losses as his more adventuresome competitor adopts newer and more efficient production techniques.

Moreover, in a modern society, technological change is self-reinforcing and almost self-generating. Major new breakthroughs in technology soon pave the way for a multitude of other changes. The production of cheap electricity for example, not only replaced gaslights, but made possible the assembly line, modern communications, and the computer.

Even if we wished to, we could not eliminate pervasive and continuous technological and economic change without remaking—on a much inferior basis—the whole fabric of our social and economic institutions. And we would not wish to. Its benefits are essential for continued economic growth, higher standards of living, and the elimination of poverty. Our objective should be to foster and encourage it.

But recognition of the many benefits of technological change must not obscure the human toll often exacted in this process of job transition—the unemployed coal miners of West Virginia, the rural migrants who crowd urban slums, the older workers forced into unwanted retirement, and the middle-aged workers whose earnings power and entitlement to fringe benefits have been eroded by the obsolescence of their skills and the loss of their seniority. We can and should reduce that toll by appropriate public and private policies.

This chapter will explore some issues and policies related to technological change in this country's economy. Some of these issues have recently been the subject of considerable public attention. There has been dispute whether the newest and most dramatic form of technical change, "automation," is a monster that threatens to destroy our whole economic order or an economic and social boon. Others debate whether automation must share the blame for the persistence for six years of an unacceptably high rate of unemployment. President Kennedy proposed—and President Johnson has repeated the proposal—that a high-level Commission on Automation be created to explore carefully these and other questions.

This chapter first points to the benefits of technological change, both those easily measurable and others less so but perhaps equally important. It then turns to a brief review of the sources of such change. It analyzes the extent to which rapid technological change may threaten the maintenance of high over-all employment and the way in which our system adjusts to the unequal impacts of technological change on regions, industries, and skills. Finally, it reviews the policies that Government can use to foster rapid technological change while at the same time helping workers to adapt to the resulting dislocations.

THE FRUITS OF ADVANCING TECHNOLOGY

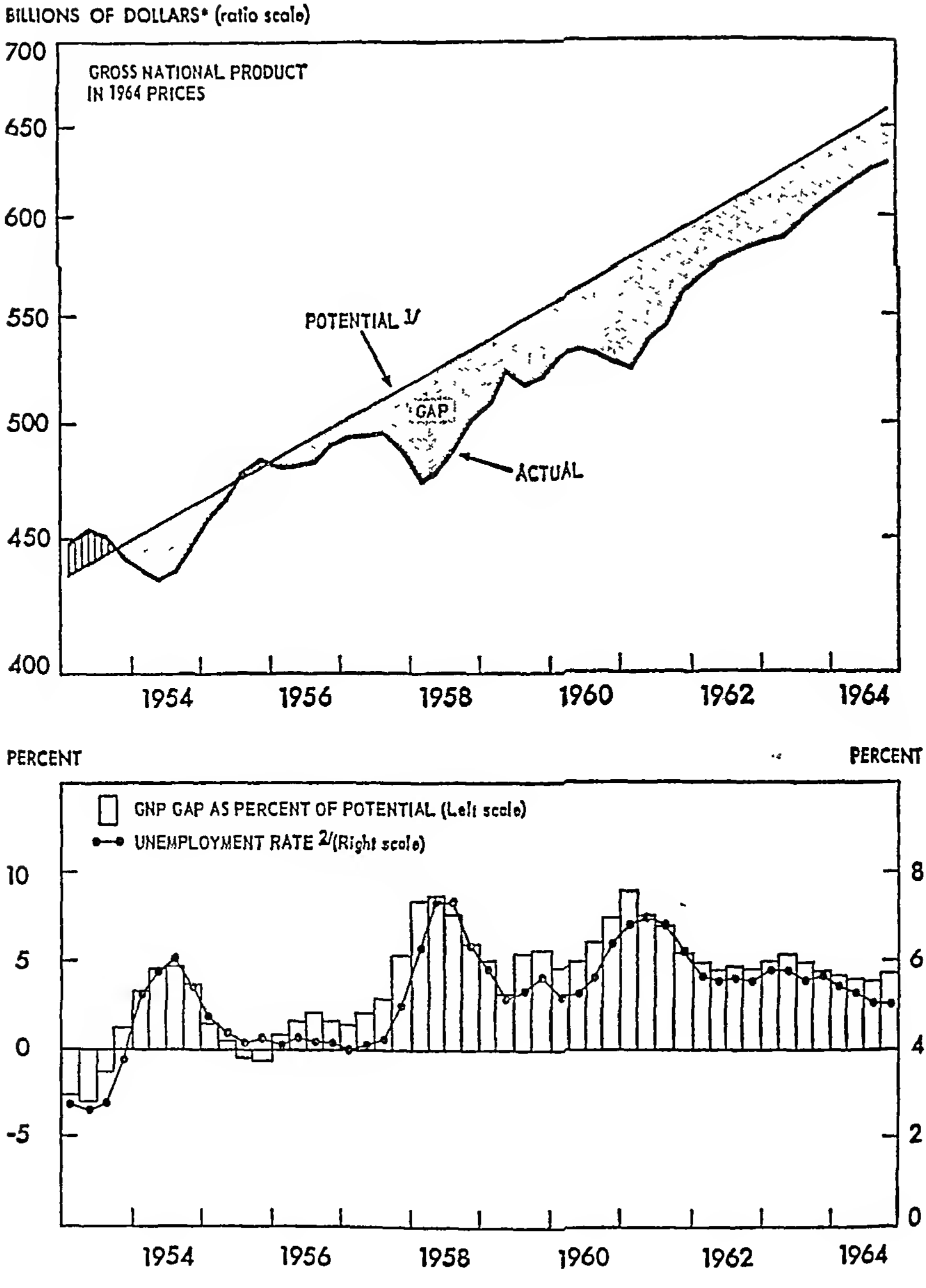
The state of technological knowledge determines what man can do with his labor, his capital, and the natural resources he finds—what can be produced and how it can be produced. Increases in our standard of living—"economic progress"—come about in considerable part from the application of new technical knowledge to production.

THE NATURE OF TECHNOLOGICAL CHANGE

By technological change we mean the introduction of new arrangements in the process of production and distribution which enable us either to produce new products, or to produce existing products more efficiently and cheaply, employing fewer real resources. The basic characteristic of technological change is that it permits us to use a given set

Chart 12

Gross National Product, Actual and Potential, and Unemployment Rate



*SEASONALLY ADJUSTED ANNUAL RATES.

1/ 3½% TREND LINE THROUGH MIDDLE OF 1955 TO 1962 IV; 3¾% TREND LINE THEREAFTER.

2/ UNEMPLOYMENT AS PERCENT OF CIVILIAN LABOR FORCE; SEASONALLY ADJUSTED.

SOURCES: DEPARTMENT OF COMMERCE, DEPARTMENT OF LABOR, AND COUNCIL OF ECONOMIC ADVISERS.

and managerial employment and because plant and equipment are being operated at inefficient rates. During periods of movement toward full employment, rapid gains in productivity reflect the fact that both workers and machines are operating more fully and more efficiently.

Actual GNP for 1964, at $622 billion, was $27 billion or 4 percent below estimated potential. In the first quarter of 1961, the gap was $51 billion (in 1964 prices) or 9 percent of potential. Thus, the current expansion has substantially narrowed the gap; its present size indicates the remaining distance to full realization of potential.

The Council's estimate of potential GNP reflects the belief that the economy could operate at a 4 percent unemployment rate today without substantial strains on either labor supplies or plant capacity. Operating rates in industry show the presence of capacity to fill additional demands. Labor supplies are generally abundant in most labor markets. While unemployment rates vary widely among different age-sex groups in the population, rates are consistently above those of 1956, when the over-all unemployment rate was 4.2 percent. . . .

Report of the Economic Council, 1967

The 1967 Economic Report stressed the importance of economic growth and introduced the idea of effective utilization of the fruits of such growth (p. 8). The Council elaborated on this concept, and indicated how the gains of growth may be used for advancing consumer levels of living as well as expanding welfare programs dealing with income maintenance, education, health, urban problems, and social security. Some of these are depicted in the following selection (pp. 135–136).

USING THE GAINS OF GROWTH

From early 1961 to the end of 1966, our GNP rose an average of $44 billion a year. About $9 billion a year was price increase. Of the balance

- An average real gain of $10 billion a year (in 1966 prices) came from putting idle men and machines back to work.
- An average real gain of $25 billion a year (in 1966 prices) came from the growth of our resources: a larger work force, more and better capital and management, higher productivity.

Further gains from putting idle resources to work will now be harder to achieve.

But our annual dividend from growth has meanwhile become more generous. In 1967 it will add $30 billion at today's prices to our potential output.

Our economic policies must assure that we realize this potential dividend—and use it wisely.

A great financier is said to have remarked that compound interest is the eighth wonder of the world. No doubt he was referring to its remarkable properties in enhancing private fortunes. However, those concerned with national policies for economic growth have also become aware of the power of compound interest. If the American economy continues to grow at 4 per cent a year, output will double in 18 years, triple in 28, quadruple in 35. If that potential is wisely and efficiently shared among competing uses, great advances in the economic well-being of all Americans are assured.

Literally billions of private and public decisions determine the distribution of the growing gross national product (GNP) among consumption, investment, and Government purchases, and—within each of these categories—among the myriad of individual goods and services the economy can provide. Consumption decisions of households and the investment of decisions of business firms determine the uses of output in the private sector. But these decisions are inevitably affected by public policies. Monetary and credit policies and changes in tax rates and tax incentives restrain or encourage consumer and business outlays and influence their composition.

The budget-making process at Federal, State, and local levels determines the share of output used to meet public needs. Taxes and public spending represent a substantial share of the national product. Moreover, in a growing economy with given tax rates, tax revenues move upward strongly over time and call for continued decisions on increases in public expenditures, tax reductions, and debt management. Public policy cannot be neutral in its impact on the allocation of the gains from economic growth. How these gains should be distributed must be squarely faced as an issue of public policy.

PRIVATE AND PUBLIC GOODS

Households directly purchase the greater part of our national output to meet their wants and needs as consumers. Personal consumption expenditures now constitute 63 percent of GNP. The share has been as low as 52 percent in World War II and as high as 83 percent in the depression year 1932, but has recently been relatively stable. Most of the future increase in output will surely take the form of more goods and services for consumers.

Consumer Choice

Growing incomes will enable households to enjoy continuing increases in their standards of living. For those families which are now poor, higher incomes will mean more of those types of goods and services which most Americans now regard as necessities—adequate and varied diets, sufficient health care, satisfactory housing, a good education for their children. Even for Americans well above the poverty line, a significant share of the growth in incomes will be devoted to these basic items. With higher

incomes, the proportion of the budget spent for various types of goods shifts in fairly predictable ways—toward consumer durable goods, travel, recreation, and other leisure-time activities. Rising incomes provide for more freedom, more security, more comforts, more cultural opportunity, and more variety in life, permitting the greater fulfillment of personal aspirations. . . .

9. FISCAL POLICY INCLUDING DEBT MANAGEMENT

THE STUDY OF macro-economics considers two instruments of government policy—fiscal and monetary. Fiscal policy refers to the attempt on the part of the Federal government to influence the level of national economic activity by manipulating its budget—increasing expenditures and reducing taxes as expansionary devices, and raising taxes and decreasing expenditures as retarding forces.

From the first Report in 1947, these documents have devoted a great deal of attention to Federal fiscal policy—finance, expenditures, revenue, and debt management. The Reports have been uneven, however, in their emphasis on the efficacy of fiscal policy. There is disagreement, too, on the timing of fiscal policy.

Fiscal Policy in a Growing Economy, Economic Report of 1964

The following excerpt (p. 42) from the 1964 Report gives a clear definition of fiscal policy.

> In a growing economy, periodic budget adjustments are required to maintain adequate expansion of total demand. The volume of tax revenues rises as incomes grow if tax rates remain unchanged. At present tax rates, the revenues that the Federal Government would collect at full employment increase by more than $6 billion a year. If program needs do not require expenditures to grow at the same rate, tax rates must be reduced, or a growing full-employment surplus will result, with increasingly restrictive effects on the economy.
>
> In the past this very process has been a major factor in slowing expansions and precipitating downturns. Thus the consequences of excessive potential surpluses have been large actual deficits, unemployment, and inability to achieve steady growth.
>
> To avoid these consequences, an appropriate expansion-promoting fiscal program would call for tax and expenditure policies that prevent a constrictive rise in the full-employment surplus.

Views of President Kennedy, National Economics Report of 1962

The 1962 Report by President Kennedy (p. 6) credited much of the improvement in the economy to the 1961 expansionary fiscal program. Note, also that the President recognized that a fiscal policy can also be retarding and recommended against such a policy at that time.

That the budget is a flexible tool which may be manipulated in both an expansionary and retarding direction also was indicated (pp. 11–12). Once recovery was under way in 1962, the necessity for continued extra stimulation from the budget was diminished. The President did recognize the uncertainty of the business outlook, and so flexibility in budgetary policy was recommended as being essential.

> The Federal Budget played its proper role as a powerful instrument for promoting economic recovery. The measures to relieve distress and restore economic momentum expanded purchasing power early in the year. Subsequently, major increases in expenditure for national security and space programs became necessary. In a fully employed economy, these increases would have required new tax revenues to match. But I did not recommend tax increases at this point because they would have cut into private purchasing power and retarded recovery. . . .
>
> . . . The Budget is appropriately paced to the expected rate of economic expansion. It will give less stimulus to business activity as private demand for goods and services grows stronger and shoulders more of the responsibility for continued gains. But the shift will be moderate and gradual. We have learned from the disappointing 1959–60 experience that an abrupt and excessively large swing in the Budget can drain the vigor from the private economy and halt its progress, especially if a restrictive monetary policy is followed simultaneously. This will not be repeated. Budget outlays will rise by $3½ billion from fiscal 1962 to fiscal 1963, whereas they fell by more than that amount from fiscal 1959 to fiscal 1960. The 1963 Budget starts from a much smaller deficit and will move to a moderate surplus as the recovery strengthens.
>
> With support from increased government expenditures and other government policies, the momentum of the recovery is expected to raise GNP to $570 billion for 1962 as a whole. Prompt enactment of the proposed tax credit for investment would give the economy further strength. Economic expansion at the expected pace will yield $93.0 billion in Budget revenues in fiscal 1963 to cover $92.5 billion in Budget expenditures. If private demands for goods and services should prove to be weaker in 1962 than now anticipated, less private purchasing power will flow into taxes, and Budget revenues will fall short of the $93.0 billion figure. If private demands are stronger, tax receipts will rise further and Budget revenues will exceed expectations.

A surplus of $4.4 billion in fiscal 1963 is expected in the national income accounts budget—a budget constructed to measure the direct impact of Federal expenditures and receipts on the flow of total spending. The surplus would be several billion dollars higher if the economy were operating steadily at a level high enough to hold unemployment to 4 percent.

Either surplus—prospective or potential—is both a challenge and an opportunity. A government surplus is a form of saving—an excess of income over expenditure. Like any other form of saving, it releases labor and other productive resources which can be used to create new investment goods—plant, equipment, or houses. If investment demand is not strong enough to use the resources and labor, they will be wasted in unemployment and idle capacity, and the surplus itself will not be realized. But if the necessary investment demand is present, the surplus will make possible the acceleration of economic growth by enlarging the future productive power of the economy. The Government is seeking to help American industry to meet this challenge and seize this opportunity, through such measures as the 8 percent investment tax credit and revisions of depreciation guidelines.

Views of the Council of Economic Advisers, 1963

The Council supported the President in its 1963 Report by reiterating the importance of fiscal policy in promoting economic expansion and growth, especially emphasizing the importance of tax reduction (p. 38).

The pace of expansion foreseen in business, consumer, and government expectations promises no easy resolution of our problem. Indeed, the prospective pace of expansion in 1963 promises little if any reduction of unemployment, little if any narrowing of the gap between actual and potential output. Positive action to invigorate the economy is required to reverse the record of the past 5 years and bring output, employment, and income up to their potential.

Accordingly, the President is recommending a major program of tax reduction and tax reform to expand private purchasing power and to strengthen private incentives—a program which will thus attack the problem of idle men and machines at its source and provide new vigor to the forces for expansion of the U.S. economy. It is the key instrument of policy for meeting our responsibilities for high employment and faster economic growth in the mid-1960's.

By reducing taxes, stimulating cost-cutting investment, strengthening incentives, and promoting a more efficient allocation of productive resources, a balanced tax program serves to lower unit costs. It thereby lays a firmer foundation for continued price stability and in improved U.S. competitive situation in world markets. . . .

A review of the role of fiscal policy and the American experience with such policy, dating back to the 1930's, was presented by the Council in its 1963 Report, as excerpted below (pp. 66–74). This excerpt examines the relationships between fiscal policy and stabilization, tax cuts as an aid to recovery, and the record of fiscal policy in the 1930's, and presents conclusions based on the record of past experiences. The importance of tax cuts is emphasized as a stimulating force, especially as a prelude to the justification for a substantial tax cut, which was to come in 1964.

Tax revision is the principal instrument of U.S. economic policy to achieve prosperity and more rapid economic growth in the mid-1960's. The nature of that revision and the means by which it will accomplish its objectives have been described in the preceding chapter.

The aim and expectation of this program is to restore full prosperity, which, in the last analysis, is the only sure path to budgetary balance. Since this will, at least temporarily, involve large budgetary deficits, it is important also to examine what deficits mean in modern economic society. Government deficits are not a new fiscal experience for Americans. The first part of this chapter reviews several relevant aspects of that experience, and in particular distinguishes two kinds of deficits and their economic effects—deficits that grow passively out of economic recession or inadequate growth, and deficits that grow out of positive fiscal action, such as tax reduction, to invigorate the economy. The perspective is further widened by placing the Federal deficit or surplus in the context of balancing and offsetting deficits and surpluses in the other major sectors of the national economy.

Since deficits increase the national debt, it is important also to appraise that debt in relation to the Nation's wealth and the Nation's income. The national balance sheet allows us to view the Federal debt as one of a set of interrelated assets and liabilities.

Expansionary tax policy must be considered also in terms of the possible effects it may have on the stability of our price level. Not only is inflation unjust and disruptive, but it would interfere with our progress toward achieving balance in our international financial accounts.

These are some of the problems discussed in this chapter. They are problems which have been considered at length in the technical literature of finance and economics. But they become problems for all Americans to consider as the Nation prepares to take bold steps to invigorate its economy—steps involving large interim Federal deficits. Both experience and analysis confirm that this positive use of fiscal policy in 1963 will make a significant contribution to the achievement of our employment and growth goals and incur minimum risks of interfering with continued price stability and progress toward balance of payments equilibrium.

PASSIVE FISCAL POLICY AND AUTOMATIC STABILIZATION

Any weakening in private spending will reduce incomes, causing tax revenues to fall and transfer payments to rise. Thus disposable incomes will decline less than pre-tax incomes, and will be partly cushioned against the decline in private demand. In effect, the impact of the decline in private income is shared with the Federal Government, which does not shrink its purchases when its income falls. The greater the extent to which a fall in government revenues cushions the decline in private incomes, the less the flow of spending for output will be curtailed.

Automatic stabilization operates in reverse when private demand increases. Additional income is generated, but part of it is siphoned out of the spending stream in higher tax payments and lower transfers. Disposable incomes therefore rise less than incomes before taxes, and the spending and re-spending is limited and damped.

Thus the tax-and-transfer response narrows fluctuations in income caused by irregularities in the strength of demand. The sharper the response of tax collections to changes in GNP, the stronger the stabilization effect. Although the tax-and-transfer response cannot prevent or reverse a movement in GNP, it can and does limit the extent of cumulative expansions and contractions. At least with respect to contractions, this is clearly an important service to the economy.

Automatic fiscal stabilizers have made a major contribution in limiting the length and severity of postwar recessions. Each of the four postwar recessions—1948–49, 1953–54, 1957–58, and 1960–61—has been both short and mild. The decline in real GNP from its peak to its trough has ranged from a high of 4.4 percent in 1957–58 to a low of 2.1 percent in 1960–61, and the duration of the recessions has varied from 9 to 13 months. Chart 8 demonstrates that changes in disposable personal income from quarter to quarter have been much smaller than changes in GNP. Although GNP changes were frequently negative (in each of the postwar recessions), disposable income fell in only one quarter in the entire postwar period. This relative stability of personal disposable income has been mainly due to the automatic fiscal stabilizers, together with the tendency of corporations to maintain their dividends at the expense of retained earnings during recessions. The maintenance of disposable incomes has prevented sharp declines in consumer expenditures. The resulting stability in markets for consumer goods, which constitute by far the largest component of final demand, has prevented any drastic collapse in business investment in fixed capital.

Automatic fiscal stabilizers increase the stability of the economy. Stability is a desirable thing for an economy that is balanced where it wants to be. Thus, an economy operating, on the average, at high levels of output and employment benefits from a tax-and-transfer system highly responsive to changes in output and income, as a cushion against sharp movements of aggregate demand either toward inflation or toward recession.

However, in the present situation—with the American economy laboring for over five years well below its potential rate of output—automatic stabilization becomes an ambiguous blessing. The protection it gives against cumulative downward movements of output and employment is all the more welcome. But its symmetrical "protection" against upward movements becomes an obstacle on the path to full employment, throttling expansion well before full employment is reached.

Under such conditions, high employment can be restored—as is being proposed under the 1963 tax program—by a reduction in taxes. When this is done the need is not primarily to lessen the responsiveness of tax receipts to changes in GNP. Rather the whole schedule of taxes should be lowered—so that, at any given GNP, taxes siphon off less private purchasing power—while leaving the response of tax receipts to *changes* in GNP about as great as before. To be sure, it is almost impossible to lower taxes without lessening to some degree their sensitivity to changes in GNP. But the purpose of such a change should be to lower the level of taxes—and hence their persistent drag on purchasing power—rather than to reduce their automatic countercyclical response.

TAX CUTS TO AID RECOVERY

Just as we have had postwar experience with automatic stabilization, we have had experience with active tax cuts which served positively to increase demand. These experiences are of interest in the present context.

In two of the postwar recessions—1948–49 and 1953–54—tax cuts helped to check the decline and to spur the ensuing recovery. Neither of the tax cuts is an example of deliberate countercyclical fiscal action, but both had important expansionary effects which came when they were needed.

Under the Revenue Act of 1948, which was passed by the Congress in April, taxes were reduced by $4.7 billion. While at the time, the tax cut appeared inappropriately timed—few observers were predicting recession—when the recession of 1949 in fact occurred, it turned out to be fortunate that the tax cut had been legislated. The cut was retroactive to January 1, 1948, and as a result refunds were exceptionally large in mid-1949. The upturn began in October 1949. In addition to the tax cut, there was a significant increase in Federal expenditures in late 1948 associated with the introduction of the Marshall Plan. This also helped to mitigate the recession. The economy was further stimulated in the expansion phase by the heavy increases in placement of military orders associated with the Korean War, which began in June 1950. As a result of the tax cut and the increased expenditures, together with the effects of the automatic stabilizers, the recession was short and mild, and the ensuing expansion was strong. By the first quarter of 1951, unemployment had been reduced to 3.5 percent of the labor force.

As a result of the rapid expansion, by the second quatrer of 1950, Federal tax liabilities as shown in the national income accounts had risen

substantially above the levels that prevailed at the time taxes were cut in the second quarter of 1948.

Taxes also were cut during the recession of 1953–54. Effective January 1, 1954, the excess profits tax was repealed, and personal income tax rates were reduced. Excise taxes were reduced on April 1, and further tax reductions for both individuals and corporations were embodied in the Internal Revenue Code of 1954. These measures are estimated to have reduced Federal revenues by about $6.1 billion (seasonally adjusted annual rate) in the first half of 1954. Further cuts which went into effect later brought the revenue loss on a full-year basis to about $7.4 billion. These cuts in personal and corporate income and excise taxes were partially offset, however, by an increase of about $1.4 billion (annual rate) in OASI contributions, which became effective on January 1, 1954. For the most part, the tax reductions in 1954 were part of a program of tax reform and were not viewed primarily as fiscal policy measures aimed at countering the recession. Yet as a result of the tax cuts that became effective at the beginning of 1954, disposable personal income and personal consumption expenditures turned up in the first quarter, while personal income and GNP were still declining. It is generally agreed that the recession ended in August. Tax reduction, together with an easy monetary policy which made a plentiful supply of funds available to finance a strong expansion of housing and automobile demand, helped to shorten the recession and to invigorate the ensuing expansion which brought unemployment down to 4.2 percent of the labor force by the third quarter of 1955.

As a result of the expansion, by the first quatrer of 1955 total Federal tax liabilities, as shown in the national income accounts, had risen significantly above the level that pervailed in the fourth quarter of 1953 before the tax cuts were put into effect.

While the tax cuts of 1954 helped considerably in rescuing the economy from the recession, it should be recognized that had they gone into effect earlier, the recession of 1953–54 might have been completely avoided. Government expenditures (principally defense spending) were cut by nearly $11 billion between mid-1953 and mid-1954. The tax cuts took effect 6 months after expenditures began to fall. As it was, fiscal policy, taken as a whole, was contractionary in this period and was a major cause of the recession. The Federal deficit as shown in the national income and product accounts was $7.0 billion (seasonally adjusted annual rate) in the second quarter of 1953 when the recession began. By the fourth quarter the operation of the automatic stabilizers associated with the decline in economic activity had increased the deficit to $11.8 billion despite significant cuts in expenditures. The deficit dropped to $10.6 billion in the first quarter of 1954, and as a result of sharp cuts in expenditures, to $5.4 billion in the second quarter despite the tax reductions that went into effect in the first half of 1954.

Private scholars who have studied the period have estimated that if the

period the contractionary policy coincided with and intensified the monetary collapse, and in the second choked off the 1937 recovery.

(3) State and local government budgets were then much larger than the Federal budget, and they were changed in a highly restrictive manner, shifting from a deficit in 1929 to surpluses after 1934.

(4) Unemployment melted away very rapidly when military needs began in 1941 to lead to large budget deficits. Of course, as these expenditures and deficits grew during the war, they not only restored full employment but became a serious inflationary danger. But this wartime overdose of expansionary fiscal medicine should not obscure the fact that more moderate dosages in the early stages quickly solved an unemployment problem which had seemed insoluble for 10 years. This was not because the expenditures happened to be military in nature—any expenditures, private or public, on the same scale would have expanded demand and put men back to work.

SOME CONCLUSIONS FROM PAST EXPERIENCE

Several conclusions emerge from the preceding review.

The automatic stabilization which our present fiscal system provides is a powerful weapon to damp cyclical movements of output and employment. It is one of the factors that has kept the U.S. economy free from major depressions in the postwar period.

The postwar record shows that deliberate tax cuts can have a countercyclical impact, encouraging recovery by stimulating private demand. The experience reviewed above shows how in two cases tax reduction contributed in this manner to recovery from recession. The fact that these tax changes came at times when they helped to check recession and encourage recovery was, however, largely accidental.

The 1948 tax reduction was intended as a permanent one, reflecting the postwar decline of military expenditures. The 1954 tax cuts were also intended as a permanent adjustment to the sharp reductions in government expenditures at the end of the Korean emergency. But a recession will not always coincide with the need for permanent tax reduction. The temporary fluctuations in private demand that are commonly responsible for cyclical movements in business activity thus may call for temporary adjustments in fiscal policy that can be reversed as the need for them recedes.

Last year the President proposed two measures for greater fiscal flexibility to meet recessions. These were (a) a proposal that the Congress grant to the President limited authority to initiate temporary reductions in personal income tax rates, subject to Congressional approval; and (b) a proposal that the Congress give the President stand-by authority to accelerate and initiate appropriately timed public capital improvements in times of serious unemployment. In his Economic Report the President

has reaffirmed his support of the principle underlying these two proposals.

A weak private economy can generate very large deficits without receiving a positively stimulating effect from those deficits. The large passive deficits of the 1930's provide examples. More recent examples appear in the experience of the past 5 years. Although the administrative budgets presented for the fiscal years 1958–63 foresaw a surplus in every year, averaging $1.4 billion, the actual outcome has been a deficit in all but one of these years, averaging $5.5 billion. . . . The discrepancy between the Administration's proposed budget and the actual fiscal outcome is, of course, accounted for by two factors: variance between actual and anticipated GNP, and Congressional action modify both expenditures and taxes. But the major factor explaining these discrepancies was the failure of the economy to attain the GNP that had been anticipated.

Passive deficits are largest when the economy experiences recession. A recession which would reduce the expected GNP gains in fiscal year 1964 by even $15 billion below what they would otherwise be would add almost $5 billion to the deficit.

The experience of the last few years should make it clear that merely to incur deficits is not an appropriate objective of policy. For it is not the deficits as such that provide stimulus. Only reductions in tax rates or increases in expenditures have an actively stimulating role. The passive deficits which are the product of recession or slack, however, have a valuable cushioning function. Nevertheless, it is an appropriate objective of policy to eliminate the deficits that are the product of a recession or a sluggish economy—because of the human and economic waste that is involved in recessions and slack. The proper objectives of policy are full employment and growth, and recessions and slack are the opposites of these.

It is clear that the deficit which a slack economy or recession produces cannot realistically be eliminated by raising tax rates or by reducing government expenditures. Its source is not excessive spending or tax rates that are too low. The attempt to eliminate a deficit by these means would be largely self-defeating. Such a policy would be disastrous for employment, incomes, profits; the deficit would remain; and the role of the dollar as an international currency would be undermined.

Expenditures that are wasteful or represent improper fields for government action (something which only the public, acting through elected representatives, can determine) should surely be eliminated. But unless taxes were simultaneously reduced by more than expenditures decline, the effect would be contractionary on the economy. The beneficial effect on incentives through lower tax rates might be more than offset by a net loss in demand. A cut in expenditures reduces market demand directly by the full amount of the cut, while an equal reduction in taxes expands market demand by a smaller amount, because a part of the reduction will be added to personal and business saving.

Deficits that result from recession or slack can be eliminated only by

> restoring and maintaining a vigorous, rapidly growing economy. If the tax system imposes an excessive drag on the economy—through its effects on purchasing power and on incentives—tax rates may be too high relative to expenditures, even though the budget is in deficit. Thus, tax revision, involving both reduction and reform, cannot only provide stimulus for growth and prosperity, but can even, as a result, balance the budget or produce surpluses. Recession and slack generate deficits; prosperity and growth balance budgets.
>
> The reciprocal relationships among surpluses and deficits in the Federal budget and the strength of the private economy can be clarified by examining the counterparts of the Federal budget for the other sectors of the economy. . . .

There are few subjects in economics about which there are as many differences of opinion between professional economists and laymen as the subject of public debt and its management, both of which are closely related to fiscal policy. The Council's 1963 Report examined the Federal debt, discussed the extent of its impact, and reviewed its expansionary and retarding potentials (pp. 81–83).

> FEDERAL DEBT AND NATIONAL WEALTH
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> Our national wealth consists of real objects which yield direct services to us (such as the family automobile) or enable us to produce more or better goods and services (the machines in a factory). It also includes the amount by which Americans' claims on foreigners exceed foreigners' claims against Americans.
>
> The measured national wealth, together with the skills and efforts of our labor force, constitutes the productive capacity of the American economy, the source of each year's output. In turn, the portion of annual output devoted to net investment equals the yearly addition to our national wealth—in the form of productive equipment, plants, houses, schools, post offices, and so on. The national wealth grows rapidly in prosperous years when investment is high and slowly in years of recession and slack. Thus, Table 12 shows that during the depressed 1930's national wealth actually declined; during both the prosperous 1920's and 1950's it increased substantially.
>
> If our public debt were owned by foreigners, it would be a deduction from our national wealth and would place a direct burden on our economy by requiring us to export part of our total output to cover interest and amortization. But our public debt is nearly 95 percent internally held. Public debt held by Americans neither directly increases nor directly reduces national wealth. Also, it is not directly related to the asset holdings of the Government—although it may be noted that a recent report of the House Government Operations Committee estimates that the total wealth, including military assets, owned by the U.S. Government, exceeds its debt.

TABLE 12.—*Civilian national wealth, selected years, 1900–1958*

[Billions of dollars, 1947–49 prices]

End of year	National wealth [1]			Net foreign assets
	Total	Privately owned	Publicly owned	
1900	314.6	292.0	22.6	−5.9
1912	464.7	423.5	41.2	−4.8
1922	588.2	532.5	55.7	12.0
1929	778.0	700.2	77.8	18.2
1933	742.2	644.7	97.5	15.8
1939	748.4	623.2	125.2	3.1
1945 [2]	758.7	623.5	135.2	1.2
1945 [2]	788.4	647.1	141.3	−2.7
1948	812.9	671.7	141.2	3.0
1950	949.1	790.6	158.5	12.0
1954	1,086.3	907.8	178.5	12.8
1958	[3] 1,244.5	1,041.7	202.8	18.9

[1] Includes net tangible wealth and net foreign assets; excludes military assets.
[2] Two estimates for 1945: the first comparable with data for earlier years and the second comparable with data for later years.
[3] Total in 1958 prices is $1,702.8 billion.

Source: Raymond W. Goldsmith, *The National Wealth of the United States in the Postwar Period.*

The tax program that is being proposed for enactment this year will bring about an increase in investment, both by raising demand and reducing excess capacity and by increasing incentives and the availability of funds. Thus, it will increase the accumulation of real capital and add to our national wealth.

Under other circumstances, of course, a fiscal policy which involved an increase in the public debt might operate to reduce real investment and retard the growth of national wealth. For example, when employment is high and demand is pressing against capacity, deficit financing of public noninvestment expenditures may contribute to inflation or raise interest rates and thereby depress private capital formation. Changes in national debt, therefore, bear no simple relation to changes in national wealth. An increase in national debt may indirectly spur the growth of wealth under some conditions and stifle it under other conditions.

THE BURDEN OF THE PUBLIC DEBT

An understanding of the relation between national debt and national wealth helps to place the problem of debt burden in further perspective. In what respects can it be said that public debt imposes a burden on either present or future generations?

1. As indicated above, the kind of fiscal policies we follow can either increase or decrease the living standards of future generations by affecting the stock of wealth we bequeath to them. But, clearly, the tax program being proposed for enactment in 1963, which encourages both high employment and high capital formation for economic growth, will benefit future generations as well as our own. It will do so even though it results in some increase in the public debt.

2. At full employment, an increase in interest payments on the publicly held Federal debt will ordinarily require higher personal income and corporate profits taxes than would otherwise be necessary in order to prevent inflation. The resulting transfer from taxpayers to interest recipients does not constitute a direct draft on the real resources available to the American people as a whole, but it may impose a burden of a more subtle kind. By dampening incentives, the higher tax rates may reduce total output. How serious such a burden will be depends on the level of tax rates that is needed. In recent years, interest payments to the public by the Federal Government have amounted to less than 2 percent of the national income, as shown on Table 13. Moreover, the ratio of interest payments to national income has declined, and it is this ratio that matters in setting the required level of tax rates. Given the magnitudes of debt change involved in a fiscal policy for high employment, and relating them to the expected growth of our economy, it is likely that the debt burden will continue to decline.
3. A further potential disadvantage of debt service may result from its effects on income distribution. If all the debt were held by one group of investors while taxes were paid by a quite different group, undesirable distributional consequences might result. This, however, is not the case in the United States where debt-holding is fairly widely dispersed and our tax structure partially offsets the distributional effects of interest transfers.

Today's economic problem is slack, not inflation. Thus, under the present circumstances there is no reason to fear such increases in the public debt as tax reduction may entail. The ratio of interest payments on the debt to national income is small and is likely to fall, not rise. Nor is there any danger that the increase in the Federal debt will be a burden on future generations. Tax reduction will increase investment, and hence the wealth we will bequeath, not decrease it. The danger is the opposite one. By failing to take expansionary fiscal action, we will keep both consumption and investment depressed, thus hurting not only ourselves, but future generations as well. . . .

Although fiscal policy includes both the expenditure and taxation sides of the budget, in recent years greater emphasis has been given to tax policies, especially in stimulating the rapid growth of the economy in 1964–1966. The idea of tax reduction as a stimulant for growth began to appear in the Reports of the late 1950's. But it was not until 1964 that a complete program of tax reduction was enacted. The Reports do differ, however, in their emphasis on the timing of tax actions and the types of reforms to be instituted.

The Case for Tax Reduction, President Kennedy's Economic Report of 1963

The 1963 Report presented a detailed case for tax reduction and elaborated on the economic considerations involved in a wide-scale program of tax reform. A substantial portion of the Report was devoted to the economics of taxation as such (pp. XIII–XX).

TAX REDUCTION AND REFORM IN 1963

We approach the issue of tax revision, not in an atmosphere of haste and panic brought on by recession or depression, but in a period of comparative calm. Yet if we are to restore the healthy glow of dynamic prosperity to the U.S. economy and avoid a lengthening of the 5-year period of unrealized promise, we have no time to lose. Early action on the tax program . . . will be our best investment in a prosperous future and our best insurance against recession.

The Responsible Citizen and Tax Reduction

In this situation, the citizen serves his country's interest by supporting income tax reductions. For through the normal process of the market economy, tax reduction can be the constructive instrument for harmonizing public and private interests:

—The taxpayer as *consumer*, pursuing his own best interest and that of his family, can turn his tax savings into a higher standard of living, and simultaneously into stronger markets for the producer.

—The taxpayer as *producer*—businessman or farmer—responding to the profit opportunities he finds in fuller markets and lower tax rates, can simultaneously create new jobs for workers and larger markets for the products of other factories, farms, and mines.

Tax reduction thus sets off a process that can bring gains for everyone, gains won by marshalling resources that would otherwise stand idle—workers without jobs and farm and factory capacity without markets. Yet many taxpayers seem prepared to deny the nation the fruits of tax reduction because they question the financial soundness of reducing taxes when the Federal budget is already in deficit. Let me make clear why, in today's economy, fiscal prudence and responsibility call for tax reduction even if it temporarily enlarges the Federal deficit—why reducing taxes is the best way open to us to increase revenues.

Our choice is not the oversimplified one sometimes posed, between tax reduction and a deficit on one hand and a budget easily balanced by prudent management on the other. If the projected 1964 Federal cash deficit of $10.3 billion did not allow for a $2.7 billion loss in receipts owing to the new tax program, the projected deficit would be $7.6 billion. We have been sliding into one deficit after another through repeated

recessions and persistent slack in our economy. A planned cash surplus of $0.6 billion for the fiscal year 1959 became a record cash deficit of $13.1 billion, largely as the result of economic recession. A planned cash surplus of $1.8 billion for the current fiscal year is turning into a cash deficit of $8.3 billion, largely as the result of economic slack. If we were to slide into recession through failure to act on taxes, the cash deficit for next year would be larger *without* the tax reduction than the estimated deficit *with* tax reduction. Indeed, a new recession could break all peace-time deficit records. And if we were to try to force budget balance by drastic cuts in expenditures—necessarily at the expense of defense and other vital programs—we would not only endanger the security of the country, we would so depress demand, production, and employment that tax revenues would fall and leave the government budget still in deficit. The attempt would thus be self-defeating.

So until we restore full prosperity and the budget-balancing revenues it generates, our practical choice is not between deficit and surplus but between two kinds of deficits: between deficits born of waste and weakness and deficits incurred as we build our future strength. If an individual spends frivolously beyond his means today and borrows beyond his prospects for earning tomorrow, this is a sign of weakness. But if he borrows prudently to invest in a machine that boosts his business profits, or to pay for education and training that boost his earning power, this can be a source of strength, a deficit through which he builds a better future for himself and his family, a deficit justified by his increased potential.

As long as we have large numbers of workers without jobs, and producers without markets, we will as a Nation fall into repeated deficits of inertia and weakness. But, by comparison, if we enlarge the deficit temporarily as the by-product of our positive tax policy to expand our economy this will serve as a source of strength, not a sign of weakness. It will yield rich *private* dividends in higher output, faster growth, more jobs, higher profits and incomes; and, by the same token, a large *public* gain in expanded budget revenues. As the economy returns to full employment, the budget will return to constructive balance.

This would not be true, of course, if we were currently straining the limits of our productive capacity, when the dollars released by tax reduction would push against unyielding bottlenecks in industrial plant and skilled manpower. Then, tax reduction would be an open invitation to inflation, to a renewed price-wage spiral, and would threaten our hard-won balance of payments improvement. Today, however, we not only have unused manpower and idle plant capacity; new additions to the labor force and to plant capacity are constantly enlarging our productive potential. We have an economy fully able and ready to respond to the stimulus of tax reduction.

Our need today, then, is

—to provide *markets* to bring back into production underutilized plant and equipment;

—to provide *incentives* to invest, in the form both of wider markets and larger profits—investment that will expand and modernize, innovate, cut costs;

—most important, by means of stronger markets and enlarged investment, to provide *jobs* for the unemployed and for the new workers streaming into the labor force during the sixties—and, closing the circle, the new jobholders will generate still larger markets and further investment.

It was in direct response to these needs that I pledged last summer to submit proposals for a top-to-bottom reduction in personal and corporate income taxes in 1963—for reducing the tax burden on private income and the tax deterrents to private initiative that have for too long held economic activity in check. Only when we have removed the heavy drag our fiscal system now exerts on personal and business purchasing power and on the financial incentives for greater risk-taking and personal effort can we expect to restore the high levels of employment and high rate of growth that we took for granted in the first decade after the war.

Taxes and Consumer Demand

In order to enlarge markets for consumer goods and services and translate these into new jobs, fuller work schedules, higher profits, and rising farm incomes, I am proposing a major reduction in individual income tax rates. Rates should be cut in three stages, from their present range of 20 to 91 percent to the more reasonable range of 14 to 65 percent. In the first stage, beginning July 1, these rate reductions will cut individual liabilities at an annual rate of $6 billion. Most of this would translate immediately into greater take-home pay through a reduction in the basic withholding rate. Further rate reductions would apply to 1964 and 1965 incomes, with resulting revenue losses to be partially offset by tax reforms, thus applying a substantial additional boost to consumer markets.

These revisions would directly increase the annual rate of disposable after-tax incomes of American households by about $6 billion in the second half of 1963, and some $8 billion when the program is in full effect, with account taken of both tax reductions and tax reform. Taxpayers in all brackets would benefit, wtih those in the lower brackets getting the largest proportional reductions.

American households as a whole regularly spend between 92 and 94 percent of the total after-tax (disposable) incomes they receive. And they generally hold to this range even when income rises and falls; so it follows that they generally spend about the same percentage of dollars of income added or subtracted. If we cut about $8 billion from the consumer tax load, we can reasonably expect a direct addition to consumer goods markets of well over $7 billion.

A reduction of corporate taxes would provide a further increment to the flow of household incomes as dividends are enlarged; and this, too, would directly swell the consumer spending stream.

The direct effects, large as they are, would be only the beginning. Rising output and employment to meet the new demands for consumer goods will generate new income—wages, salaries, and profits. Spending from this extra income flow would create more jobs, more production, and more incomes. The ultimate increases in the continuing flow of incomes, production, and consumption will greatly exceed the initial amount of tax reduction.

Even if the tax program had no influence on investment spending—either directly or indirectly—the $8–9 billion added directly to the flow of consumer income would call forth a flow of at least $16 billion of added consumer goods and services.

But the program will also generate direct and indirect increases in investment spending. The production of new machines, and the building of new factories, stores, offices, and apartments add to incomes in the same way as does production of consumer goods. This too sets off a derived chain reaction of consumer spending, adding at least another $1 billion of output of consumer goods for every $1 billion of added investment.

Taxes and Investment

To raise the Nation's capacity to produce—to expand the quantity, quality, and variety of our output—we must not merely replace but continually expand, improve, modernize, and rebuild our productive capital. That is, we must invest, and we must grow.

The past half decade of unemployment and excess capacity has led to inadequate business investment. In 1962, the rate of investment was almost unchanged from 1957 though gross national product had risen by almost 16 percent, after allowance for price changes. Clearly it is essential to our employment and growth objectives as well as to our international competitive stance that we stimulate more rapid expansion and modernization of America's productive facilities.

As a first step, we have already provided important new tax incentives for productive investment. Last year the Congress enacted a 7-percent tax credit for business expenditures on major kinds of equipment. And the Treasury, at my direction, revised its depreciation rules to reflect today's conditions. Together, these measures are saving business over $2 billion a year in taxes and significantly increasing the net rate of return on capital investments.

The second step in my program to lift investment incentives is to reduce the corporate tax rate from 52 percent to 47 percent, thus restoring the pre-Korean rate. Particularly to aid small businesses, I am recommending that effective January 1, 1963, the rate on the first $25,000 of corporate income be dropped from 30 to 22 percent while the 52 percent rate on corporate income over $25,000 is retained. In later stages, the 52 percent rate would drop to 47 percent. These changes will cut corporate liabilities by over $2.5 billion before structural changes.

The resulting increase in profitability will encourage risk-taking and enlarge the flow of internal funds which typically finance a major share

of corporate investment. In recent periods, business *as a whole* has not been starved for financial accommodation. But global totals mask the fact that thousands of small or rapidly growing businesses are handicapped by shortage of investible funds. As the total impact of the tax program takes hold and generates pressures on existing capacity, more and more companies will find the lower taxes a welcome source of finance for plant expansion.

The third step toward higher levels of capital spending is a combination of structural changes to remove barriers to the full flow of investment funds, to sharpen the incentives for creative investment, and to remove tax-induced distortions in resource flow. Reduction of the top individual income tax rate from 91 to 65 percent is a central part of this balanced program.

Fourth, apart from *direct* measures to encourage investment, the tax program will go to the heart of the main deterrent to investment today, namely, inadequate markets. Once the sovereign incentive of high and rising sales is restored, and the businessman is convinced that today's new plant and equipment will find profitable use tomorrow, the effects of the directly stimulative measures will be doubled and redoubled. Thus —and it is no contradiction—the most important single thing we can do to stimulate investment in today's economy is to raise consumption by major reduction of individual income tax rates.

Fifth, side-by-side with tax measures, I am confident that the Federal Reserve and the Treasury will continue to maintain, consistent with their responsibilities for the external defense of the dollar, monetary and credit conditions favorable to the flow of savings into long-term investment in the productive strength of the country.

Given a series of large and timely tax reductions and reforms, as I have proposed, we can surely achieve the balanced expansion of consumption and investment so urgently needed to overcome a half decade of slack and to capitalize on the great and growing economic opportunities of the decade ahead.

The impact of my tax proposals on the budget deficit will be cushioned by the scheduling of reductions in several stages rather than a single large cut; the careful pruning of civilian expenditures for fiscal 1964—those other than for defense, space, and debt service—to levels below fiscal 1963; the adoption of a more current time schedule for tax payments of large corporations, which will at the outset add about $1½ billion a year to budget receipts; the net offset of $3½ billion of revenue loss by selected structural changes in the income tax; most powerfully, in time, by the accelerated growth of taxable income and tax receipts as the economy expands in response to the stimulus of the tax program.

Impact on the Debt

Given the deficit now in prospect, action to raise the existing legal limit on the public debt will be required.

The ability of the Nation to service the Federal debt rests on the in-

come of its citizens whose taxes must pay the interest. Total Federal interest payments as a fraction of the national income have fallen, from 2.8 percent in 1946 to 2.1 percent last year. The gross debt itself as a proportion of our GNP has also fallen steadily—from 123 percent in 1946 to 55 percent last year. Under the budgetary changes scheduled this year and next, these ratios will continue their decline.

It is also of interest to compare the rise in Federal debt with the rise in other forms of debt. Since the end of 1946, the Federal debt held by the public has risen by $12 billion; net State-local debt, by $58 billion; net corporate debt, by $237 billion; and net total private debt, by $518 billion.

Clearly, we would prefer smaller debts than we have today. But this does not settle the issue. The central requirement is that debt be incurred only for constructive purposes and at times and in ways that serve to strengthen the position of the debtor. In the case of the Federal Government, where the Nation is the debtor, the key test is whether the increase serves to strengthen or weaken our economy. In terms of jobs and output generated without threat to price stability—and in terms of the resulting higher revenue—the debt increases foreseen under my tax program clearly pass this test.

Monetary and debt management policies can accommodate our debt increase in 1963—as they did in 1961 and 1962—without inflationary strain or restriction of private credit availability.

Impact on Prices and the Balance of Payments

The Administration tax program for 1963 can strengthen our economy within a continuing framework of price stability and an extension of our hard-won gains in the U.S. balance of payments position.

Rising prices from the end of the war until 1958 led the American people to expect an almost irreversible upward trend of prices. But now prices have been essentially stable for 5 years. This has broken the inflationary psychology and eased the task of assuring continued stability.

We are determined to maintain this stability and to avoid the risk of either an inflationary excess of demand in our markets or a renewed price-wage spiral. Given the excess capacities of our economy today, and its large latent reserves of productive power, my program of fiscal stimulus need raise no such fears. The new discipline of intensified competition in domestic and international markets, the abundant world supplies of primary products, and increased public vigilance all lend confidence that wage-price problems can be resolved satisfactorily even as we approach our full-employment target.

Indeed, in many respects the tax program will contribute to continued price stability. Tax reduction and reform will increase productivity and tend to cut unit labor costs by stimulating cost-cutting investment and technological advance, and reducing distortions in resource allocation. As long as wage rate increases stay within the bounds of productivity

increases, as long as the push for higher profit margins through higher prices is restrained—as long as wage and price changes reflect the "guideposts" that were set out a year ago and are reaffirmed in the accompanying Report of the Council of Economic Advisers—the outlook for stable prices is excellent.

Price stability has extra importance today because of our need to eliminate the continuing deficit in the international balance of payments. During the past 2 years we have cut the over-all deficit, from nearly $4 billion in 1960 to about $2 billion in 1962. But we cannot relax our efforts to reduce the payments deficit still further. One important force working strongly in our favor is our excellent record of price stability. Since 1959, while U.S. wholesale prices have been unchanged, those in every major competing country (except Canada) have risen appreciably. Our ability to compete in foreign markets—and in our own—has accordingly improved.

We shall continue to reduce the overseas burden of our essential defense and economic assistance programs, without weakening their effectiveness—both by reducing the foreign exchange costs of these programs and by urging other industrial nations to assume a fairer share of the burden of free world defense and development assistance.

But the area in which our greatest effort must now be concentrated is one in which Government can provide only leadership and opportunity; private business must produce the results. Our commercial trade surplus—the excess of our exports of goods and services over imports—must rise substantially to assure that we will reach balance of payments equilibrium within a reasonable period.

Under our new Trade Expansion Act, we are prepared to make the best bargains for American business that have been possible in many years. We intend to use the authority of that act to maximum advantage to the end that our agricultural and industrial products have more liberal access to other markets—particularly those of the European Economic Community.

With improved Export-Import Bank facilities and the new Foreign Credit Insurance Association, our exporters now have export financing comparable to that of our major competitors. As an important part of our program to increase exports, I have proposed a sharp set-up in the export expansion program of the Department of Commerce. Funds have been recommended both to strengthen our overseas marketing programs and to increase the Department's efforts in the promotion of an expanded interest in export opportunities among American firms.

In the meantime, we have made and will continue to make important progress in increasing the resistance of the international monetary system to speculative attack. The strength and the stability of the payments system have been consolidated during the past year through international cooperation. That cooperation successfully met vigorous tests in 1962—when a major decline occurred in the stock markets of the world; when

of nearly $9 billion would result in a direct increase of more than $8 billion in consumption. Subsequent rounds of spending and respending would add another $10 billion to consumption—producing a tax cut "*multiplier*" *of about two*. Thus, through increased consumption alone, GNP would ultimately be raised by more than $18 billion above what it would have been in the absence of the tax cut.

The evidence to date indicates that this expectation is being borne out. After rising to 7.9 percent in the second quarter of 1964, the ratio of personal saving to disposable income had fallen back to a relatively normal 7.1 percent in the third quarter, suggesting that the gains of disposable income resulting from tax reduction were already being largely spent for the purchase of consumer goods and services. (A jump in the saving rate in the fourth quarter appears to be attributable to delayed deliveries of automobiles as a result of strikes.) The tax cut directly added $7.7 billion to disposable income in 1964, and the addition was *running at an annual rate of $9½ billion by the end of the year*. The Council estimates that the total increase in consumer spending alone resulting from the tax cut's impact was $9 billion in 1964, and had reached an annual rate of $18 billion by the end of the year. Subsequent rounds of spending and respending will bring the full impact on consumption in 1965 and beyond.

From 1963 to 1964, GNP grew 4.5 percent after adjustment for price changes. The above calculations suggest that, in the absence of the tax cut, the growth would have been only 3.0 percent, even if it is assumed that without the tax cut all expenditures other than consumption would have been just what they in fact were.

These figures, however, underestimate the full beneficial effects of the cut. Tax policies were also prominent among the factors that helped to generate a $5.0 billion advance (current prices) in business fixed investment between the fourth quarters of 1963 and 1964. The depreciation reform and the investment credit of 1962 continued to provide added strength to capital spending. The Revenue Act of 1964 reduced the basic rates of corporation taxes and, by increasing consumer demand, gave businessmen added assurance of sustained expansion and expanded markets. This assurance was a stimulating factor, even before tax cuts added to sales or cash flow. As the tax cut raised cash flows and operating rates during the year, business investment plans were revised upward.

Since the full effects on business investment of greater sales, improved profits, and larger cash flow are accomplished only after a substantial lag, and since part of the tax cut becomes effective in 1965, much of the rise in investment stimulated by the 1964 tax cut is still ahead of us. This extra investment will have multiplied effects on total production through the route of expanded incomes and larger consumer spending. . . .

Federal policies have made a major and continuing contribution to the great achievements of the American economy during the past four years. These policies were not laid down in one master plan early in 1961 and

this continuous balance between demand and capacity normally involves two basic requirements. First, since total productive capacity grows steadily over time, total demand also must grow. Second, since fluctuations in private demand occur independently of Federal policy, these fluctuations must be offset in order to avoid dips or surges that could touch off recession or inflation.

Since 1960, a third requirement has been added as the result of earlier failures to meet the first two: the need to eliminate the large gap that developed in the late 1950's between potential output and demand. Thus, in the last four years the main challenge to U.S. policy has been to stimulate a massive growth in total demand, sufficient not merely to *keep up* but to *catch up* with the growth of productive capacity. During the past four years, fiscal policy has been dominated by this purpose. In addition to a growth of $21 billion in Federal expenditures (first quarter 1961 to fourth quarter 1964), reductions in tax liabilities now in effect leave about $16 billion more a year in private hands than would be the case under 1960 tax rates.

As previous Annual Reports have shown, the stimulus provided by a given budget cannot be measured by the realized surplus or deficit. Since tax revenues and some expenditures automatically vary with economic activity, the realized surplus or deficit reflects the automatic effect of these variations, as well as discretionary actions on the part of the Federal Government. To distinguish the two effects, revenues and expenditures are calculated at a fixed level of economic activity—usually the full-employment level. At any given time, the larger the surplus at full-employment, the more restrictive is fiscal policy; changes in the full-employment surplus or deficit indicate whether fiscal policy has, on balance, moved in an expansionary or a restrictive direction. This concept cannot measure perfectly the effect of a given budgetary change because it does not reflect changes in the composition of the budget. Moreover, a rise in the level of the budget may have a stimulating effect even with no change in the full-employment surplus. But the full-employment surplus is the best simple measure available and is a useful tool of analysis.

For the calendar year 1960, the Federal budget, on a national income and product account basis, showed an actual surplus of $3.5 billion, but the full-employment surplus was about $13 billion (Chart 9). Given the extent of the unutilized human and material resources, this surplus obviously needed to be reduced.

During 1961 a sharp increase in expenditures had an expansionary impact on the economy. As this increase was in excess of built-in gains in revenue at full employment, a first step was taken toward reducing the full-employment surplus. After the initial increase, the growth of expenditures continued at a substantial though slowing pace through the following two years. From the first quarter of 1961 to the fourth quarter of 1963, total Federal expenditures, which include transfer payments, subsidies, interest, and grants-in-aid, as well as purchases of goods and

services, increased by $17 billion, or roughly 17 percent. These expenditures, undertaken primarily to strengthen defense and space programs but also to provide for unmet civilian needs, directly raised the level of aggregate demand and were highly stimulating to the rest of the economy.

The stimulus of fiscal policy was not limited to the expenditure side of the budget. Two tax-reducing measures were adopted to provide a needed long-run stimulus to lagging private investment. New depreciation guidelines were announced in July 1962, and an investment tax credit was enacted by Congress in the Revenue Act of 1962. The net effect of these two measures was to increase by $2½ billion the annual cash flow to corporations and to increase appreciably the after-tax rate of return on new investment projects, thus providing a needed long-range stimulus to investment. Through a combination of expenditure increases and tax reductions, the full-employment surplus was reduced to about $6½ billion in 1962. . . .

Fiscal Policy to Sustain Expansion

Fiscal policy is the Federal Government's most powerful instrument for influencing total demand. Changes in Federal purchases of goods and services can have an important effect on over-all economic activity. Similarly, variations in Federal taxes and transfer payments have major influence on the flow of after-tax earnings to private spending units.

As discussed in Chapter 1, the full-employment surplus is a useful measure of the over-all impact of the Federal budget on economic activity. Changes in this surplus indicate whether the Federal budget is becoming more or less expansionary. When aggregate demand needs a stimulus in order to achieve full employment, it is appropriate to reduce the full-employment surplus. When a restrictive influence is called for, the full-employment surplus should be raised.

As our productive capacity grows through time, so do Federal tax revenues at full employment. Indeed, the percentage growth in Federal revenues tends to exceed slightly the growth in potential GNP. Consequently, if Federal tax rates are unchanged and expenditures grow less rapidly than potential output, the full-employment surplus tends to rise, restricting the expansion of total demand. When the economy is threatened with excessive demand, this restrictive influence is desirable. But it is not appropriate when the economy is well below full employment. The need for fiscal measures to prevent undesired increases in the full-employment surplus also provides opportunities to pursue important national goals; by expanding or initiating vital Federal programs, by assistance to State and local governments, or by further tax reductions or increases in transfer payments to individuals.

Uses of expanding revenues

Many national needs will be met only if the Federal Government takes the lead. While increasing efficiency within the Government will serve to hold down the growth of budget expenditures, it is to be expected that

Federal nonmilitary outlays will increase in 1965 and the years beyond. Some of these outlays will be public investments in physical capital and human resources. Grants are also likely to rise as the Federal Government assists State and local governments in strengthening public services that are best provided at the local level. Transfer payments will increase, as a compassionate society strives to aid the needy and to provide greater security for all its citizens. And a growing and more prosperous population will need and desire improved public services as part of a higher standard of living.

Tax reduction also offers attractive benefits. It provides opportunities for raising living standards through private consumption. Furthermore, lower income tax rates can strengthen the incentives to undertake risks, to work, and to exercise initiative. Thus tax cuts can invigorate markets and encourage the supply of new products and services through private enterprise.

Choices and requirements of budget policy

The allocation of our potential growth in revenues should reflect national priorities. To the extent that a democratic society desires to make additional resources available to meet pressing public needs and wants, increased Government outlays are called for. Alternatively, tax rate reductions give priority to private uses of resources. The criteria for this choice are not primarily economic. But economic analysis clearly indicates that, unless excess demand threatens, the Nation's fiscal dividend must be allocated between increased outlays and reduced taxes. Only in this way can fiscal policy promote sustained prosperity.

Fiscal policies for other objectives

Fiscal policies to achieve and maintain full employment must be shaped to permit simultaneous progress toward other economic objectives, including more rapid growth of potential output and improved international balance. Fortunately, fiscal policy is a versatile kit of tools. Through changes in the structure of taxes and the composition of public expenditures, it can contribute to these other goals.

The recent reductions in corporate tax rates, the investment tax credit, and depreciation reform, by increasing both financial resources and profitability, have stimulated investment and have contributed to the growth of potential output. The composition of public expenditures this year will put increased emphasis on education, which will improve the skills of the labor force and will speed technological advance. Federal expenditures for resource development, transportation, and research will open up profitable new investment opportunities for private enterprise. Such fiscal steps to raise the rate of growth are particularly important in periods when downward adjustments of interest rates are limited.

Similarly, financial measures directly affecting the international area, such as changes in the tax treatment of foreign earnings enacted in 1962

and proposed measures to improve the tax treatment of foreign portfolio investment in the United States, can influence capital flows and hence the balance of payments. Finally, special taxes, such as the Interest Equalization Tax, can be appropriately used under some conditions. Such special taxes cannot be properly considered basic elements of long-run policy, since they qualify the freedom of international trade and capital movements. In particular circumstances, however, they can be the least costly and least disruptive way of dealing with temporary pressures.

Current fiscal program

With the economy currently below full-employment levels, continued rapid expansion of output is called for in 1965. Federal budgetary policy has been designed with this need in mind. Past fiscal measures lowering individual and corporate taxes will continue to strengthen the economy this year. The income tax cut will reach its full effect on consumer demand and have added influence on investment. In addition, new fiscal actions to sustain the expansion of the economy are set forth in the President's proposed budget.

In accordance with the Revenue Act of 1964, tax rates on 1965 incomes will be lower than those last year. Most of the tax cut's direct effect on disposable income, however, was experienced beginning in March 1964 when the withholding rate fell from 18 percent to 14 percent. This year, taxpayers will benefit from twelve rather than ten months of lower withholding, but the withholding rate will be unchanged. Hence, the "second stage" of the personal income tax cut will provide very little fresh stimulus. Indeed, when final settlements of 1964 taxes are made this spring, tax refunds will be reduced by more than $1 billion from last year's level, because the withholding rate was lowered in 1964. Nevertheless, the consumption-increasing effects of the original gain in disposable income have not as yet been fully realized. Expenditures out of the initial gain in income, in turn, lead to higher income in a continuing, but diminishing, chain. The time lags in this process are such that as much as one-fourth of the full annual consumption effect of the tax cut—or a gain of $5 billion—remains to be felt during 1965.

Favorable repercussions on investment should also continue. With the stimulus of improved operating rates, higher before-tax profits, and lower corporate taxes, business fixed investment rose strongly during 1964. Since even more substantial lags exist in investment spending, and since corporate profit tax rates are reduced by another 2 percentage points in 1965, tax reductions are continuing to strengthen fixed capital outlays. . . .

Policies can respond to unanticipated developments as they emerge. But they would be faced by a dilemma if price-wage pressures were to threaten our record of price stability while the economy remained below full employment. Under such circumstances, restrictive measures might offer a weak antidote to inflation by making the environment less favor-

able for price increases; but at the same time these policies could have a sharply adverse effect on employment and could impair the productivity gains that permit higher wage rates within a framework of constant unit labor costs.

Fiscal Policy to Combat Recession

Flexibility in fiscal policy is especially important when the economy is suddenly threatened with recession. Continuing policies to strengthen expansion supply a solid first line of protection against recurrent recession. But imbalances can develop in a free enterprise economy, and can trigger costly and cumulative downturns in business activity. Automatic fiscal stabilizers help to cushion the economy in a period of declining activity. But they must be supplemented by strong and prompt discretionary fiscal actions if we are to minimize the severity of recessions.

Flexible use of fiscal policy requires cooperative efforts by the Administration, the Congress, and the public. The Administration is determined to recognize the problem candidly and to take decisive action promptly when economic activity is faltering. The Congress contributes by being prepared to consider the President's proposals with all possible speed. The public—consumers, business, and labor—can be expected to regard constructive Government policies to combat recession as a source of strength rather than as a reflection of weakness. The bright prospects for continued expansion this year offer an opportunity to review the available means for such cooperative action, so that our defenses will be strong when and if they are tested in the future.

Costs of Recessions

Even minor recessions have huge costs. In the postwar period, the United States has successfully avoided a recurrence of the seriously depressed conditions of the 1930's, but it has experienced four recessions which caused personal hardship for millions of Americans. During the course of these recessions, on average, real GNP fell by more than 3 percent; the unemployment rate rose by 2 percentage points; and corporate profits fell by more than 25 percent. In the years most heavily scarred by recession, the number of people unemployed long enough to exhaust their unemployment compensation benefits rose by 840,000; the number of families with incomes below the $3,000 poverty line rose by 400,000; and the number of families receiving general assistance payments rose by 70,000.

Automatic Stabilizers

These recessions would have been far more costly had it not been for the "built-in" fiscal stabilizers of our modern economy. During recession, Government purchases resist the decline in private outlays. Moreover, Government transfer payments rise as unemployment increases; and tax collections fall as corporate profits and wages decline. Thus, the Federal

tax-transfer system automatically draws less purchasing power out of the private sector.

In postwar recessions, built-in stabilizers have worked primarily through changes in corporate profits, the corporate tax yield, and transfer payments. The 1960–61 recession can serve as an illustration. During that recession, national income fell by $4.5 billion (annual rate), but personal income actually rose by $5.2 billion. Corporate profits bore the brunt of the decline, but reductions in corporation tax liabilities helped to maintain dividends. Increased transfer payments, including a $1.4 billion (annual rate) rise in unemployment benefits, offset some losses in earnings.

Strengthening the unemployment compensation system deserves high priority among possible steps to increase the automatic resistance of the economy to recessions. The most important reasons for improving the system are to increase individual security and reduce the unnecessary human costs of unemployment. But a strengthened system would also sustain consumer purchasing power more effectively, thereby reducing the amount of unemployment as well.

At present, the unemployment insurance system excludes about one-fifth of all workers; a particularly unfortunate omission is employees of small firms who are by no means immune to unemployment. Furthermore, average benefits presently amount to only about 35 percent of average wages in covered employment; in 1939, the average benefit was more than 40 percent of average covered wages. Finally, with the present maximum duration of benefit payments, a particularly large number of recipients exhaust their benefits during a recession period before new employment opportunities develop. During 1961, about 2.4 million workers exhausted benefits despite the relatively rapid upturn in business activity from the 1960–61 recession. A series of Administration proposals for strengthening the unemployment compensation system is being sent to Congress this year.

Discretionary Actions on Taxes and Expenditures

Although automatic stabilizers do much to moderate recessions, they cannot be relied on either to prevent them or to turn the tide. Federal taxing and spending measures that reduce the full-employment surplus can, however, be effective in reversing recession.

As the President has stated, ". . . *if* recession were to threaten, a well-timed tax cut would be one of our most effective measures." Therefore, he is asking Congress to consider how a temporary income tax reduction can be "well-timed" to combat recession. The President is suggesting that Congress itself evaluate its procedures and determine the best way to reinforce the Nation's confidence that an anti-recession tax proposal would be considered and voted on promptly.

Accelerated Government spending can also provide powerful assistance to the economy if recession should threaten. As noted in Chapter 1, rapid increases in Federal outlays were called for in 1961 to strengthen national

security; these outlays also helped to spur recovery from the recession. In the future, we cannot count on new public expenditure requirements to develop just at the time of recession. Nevertheless, there are many continuing public needs which provide opportunities for expanding Federal outlays if additional fiscal stimulus becomes appropriate. These opportunities must be grasped promptly if they are to have maximum effectiveness. Yet such increases in spending should not commit the Government to a higher level of outlays than would otherwise be desirable, once the economy recovered.

Advance planning makes possible a careful selection of those expenditure programs which could be most efficiently and most rapidly expanded in time of recession and contracted after recovery. This would assure that agencies have workable anti-recession plans on hand, permitting speedier action by the Administration and Congress and improving the efficiency of stepped-up expenditures.

The anti-recession possibilities of a wide range of Federal programs will be reviewed by the Administration this year. Certain maintenance, rehabilitation, and modernization activities on Federal facilities, or on State and local facilities assisted by Federal grants, provide opportunities to push funds rapidly through already existing "pipelines." Unlike certain traditional public works, many of these activities could be expanded readily, employing workers without previous similar job experience and not requiring commitment to a long-term program. Various training and community service programs might also be intensified appropriately, since the poverty-stricken and the unskilled are doubly disadvantaged in times of slack economic activity.

Benefits of timely anti-recession actions

If action could be taken in time, either temporary tax cuts or the accelation of selected Government programs—or the two in combination—potentially have the speed and power to repel recessions. The time patterns of the postwar recessions of 1953–54, 1957–58, and 1960–61 illustrate the possible benefits of quick action after a downturn has been diagnosed. In 1953, evidence of weakening in the economy was available by June and the forces of recession were evident by September. Symptoms of the 1958 recession were clear by November 1957; in 1960, the downturn in the economy was widely recognized by September. A tax reduction, enacted within the first quarter after recession became apparent, would have provided a substantial lift to consumer spending in the following quarter. This boost might have converted the last months of decline into the initial months of recovery. The major expansionary effect of the tax cut would then have strengthened the advance over the next few quarters.

The need for stimulation does not disappear as soon as the economy turns up. Indeed, many policy actions in the past have been designed to strengthen the early stages of recovery. Even with such measures, the

economic phenomena, however, was well demonstrated in 1967. As the year moved through its first quarter and into the second, sluggishness in the economy appeared, and so some of the retarding fiscal policies that were recommended earlier in the year were rescinded or let lie dormant. But signs of inflation later in the year, stimulated by increased Vietnam expenditures, brought renewed clamor for increased taxes. The 1967 approach is represented below, as excerpted from pp. 9–10.

In the year ahead we are determined to maintain that moderate advance; we need no further slowdown; we can tolerate no new spurt of demand. After midyear, the tax increase I have proposed and a more moderate growth of Federal spending will increase the freedom of monetary policy to support expansion. I am confident that the opportunity will be used.

The specific fiscal program I am recommending includes

—a surcharge of 6 percent on the tax liabilities of individuals, exempting persons in the lowest income brackets:

—the same 6 percent surcharge on the tax liabilities of corporations.

Here are some examples of the effect of this proposal, as applied to a married couple with two dependents, using typical deductions:

- With $5,000 income, their tax will be unchanged—still $130 lower than they would have paid in 1963.
- With $10,000 income, their tax in 1968 will rise $67, or $1.30 a week. Their annual tax will still be $190 less than they would have paid in 1963.
- With $20,000 income, their tax in 1968 will rise $190, or $3.65 a week. But their annual tax will still be $450 less than they would have paid in 1963.

A corporation with profits before tax of $100,000 will pay an extra $2,490. It will still pay $2,510 less than it would have paid in 1963.

One with profits of $1,000,000 will pay an extra $28,410, still $12,590 less than it would have paid in 1963.

The surcharge will provide for $5.1 billion of extra revenues in fiscal year 1968 on a national income accounts basis, substantially offsetting the expansion of $5.8 billion in defense purchases.

The national income accounts budget will also be affected by my proposals for Social Security benefits and taxes.

After allowance for these changes, the national income accounts deficit for fiscal year 1968 is now estimated at $2.1 billion, compared with $3.8 billion in fiscal year 1967.

I am also recommending two further accelerations of corporate tax payments, to begin in 1968:

—requiring quarterly payment of estimated tax on the basis of 80 percent rather than 70 percent of liability;

—requiring, over a 5-year period, that small corporations, as well as large, become current in their tax payments, in the same way as individual proprietors.

We have fashioned a fiscal program for sustainable expansion. With that program, we now see a rise of about $47 billion in our GNP in 1967—a growth dividend close to 4 percent in real terms.

10. MONETARY POLICY

A SECOND SIGNIFICANT tool of macro-economic policy is monetary policy. Here the attempt is made to influence the level of economic activity by making money either "cheaper or dearer." This type of encouragement comes primarily through policies of the Federal Reserve System. In spite of frequent separate discussion of fiscal and monetary policies, the Economic Reports recognize the fallacy of considering each policy as an independent entity by their usual treatment of both as aspects of total Federal economic policy.

The Role of Monetary Policy

The 1964 Report (pp. 42–44) gave a clear statement of the meaning and scope of monetary policy.

> Establishing a suitable fiscal framework is not the only step the Government can take to promote full employment. The ability of the economy to maintain expansion in both its actual and its potential output is significantly affected by the monetary and debt management policies of the Federal Reserve System and the Treasury Department. Expenditures on long-lived assets, such as residential and commercial buildings, business plant and equipment, and to a lesser extent consumer durables, are particularly sensitive to cost and availability of credit, which are heavily influenced by monetary and debt management policies.
>
> The choice of monetary policies must be related to the character of private demand, to the type of fiscal policy being pursued, and to goals with respect to the balance of payments. In the light of these considerations, various combinations of fiscal and monetary policies are appropriate to different conditions in the economy.
>
> When aggregate demand is generally deficient and investment and consumption are expanding too slowly to provide jobs for all those seeking employment, expansionary monetary policy normally can and should accompany expansionary fiscal policy. Likewise, when excessive aggregate demand threatens to cause inflation, a tight monetary policy may be called for in conjunction with a fiscal program that permits full-employment Federal revenues to rise relative to expenditures.
>
> Under some circumstances, however, it may be appropriate to operate monetary policy at seeming cross purposes to fiscal policy in order to restrict [inflationary forces].

The President reported in 1962 (p. 6) how monetary policy can be employed when the economy needs stimulation. Here, the Federal Reserve System adopted a policy of monetary ease as follows:

> Monetary and credit policies responded to the dual demands of economic recovery and the balance of payments. On the one hand, the Federal Reserve System maintained general monetary ease; Federal Reserve open market operations, complemented by Treasury management of the public debt and of government investment accounts, assured an ample supply of credit which served to counter upward pressures on long-term interest rates; reduction of FHA ceiling rates, supported by FNMA mortgage purchases, eased mortgage credit and stimulated homebuilding; and the Small Business Administration made its credit more widely available at lower cost. On the other hand, both monetary and debt management policies countered downward pressures on short-term rates, with a view to checking the outflow of funds to money markets abroad.

In 1962, the President tended to rely more on fiscal policy as a contracyclical measure. While not denying a role to monetary policy, he preferred that monetary tools be reserved primarily for purposes of financial policy and international considerations, especially so long as fiscal policy is accomplishing its mission successfully. This is seen in the following excerpt (p. 18).

> *Monetary and Credit Policies*
>
> Monetary, credit, and debt management policies can also help to assure that productive outlets exist for the funds that the American people save from prosperity incomes. The balance foreseen in the Budget for fiscal year 1963, and the surplus which would arise at full employment, both indicate that fiscal policy is assuming a large share of the burden of forestalling inflationary excesses of demand. With monetary and related policies relieved of a substantial part of this burden, they can more effectively be used to assure a flow of investment funds which will transform the economy's present capacity to save into future capacity to produce.
>
> At the same time, monetary and debt management policies must continue to protect the balance of international payments against outflows of short-term capital. As in 1961, domestic expansion and the balance of payments confront these policies with a dual task, requiring continued ingenuity in technique and flexibility in emphasis. . . .

The Council elaborated on the role of monetary and credit policy (pp. 84–85) in the 1962 Report.

Monetary and Credit Policies and Economic Stability

The second major instrument of the Government for economic stabilization is monetary and credit policy, interpreted in the broadest sense to encompass all governmental actions affecting the liquidity of the economy and the availability and cost of credit. Here the Federal Government has broad and inescapable responsibilities, stemming basically from the sovereign right of Congress "to coin money, regulate the value thereof. . . ." The Government's influence is exercised in several ways—principally through Federal Reserve control of the total volume of bank reserves, but also through Treasury management of the public debt and through the administration of a variety of government lending and credit guarantee programs. These powers can significantly affect the flow of funds into business investment, capital expenditures of State and local governments, residential construction, and purchases of consumer durable goods. Monetary and credit policies can be flexible, responding at short notice to changes in economic circumstances and prospects.

In an important sense, the private economy of the United States contains automatic or "built-in" monetary stabilizers. Unless the Government acts to make compensating changes in the monetary base, expansion of general economic activity, accompanied by increased demands for liquid balances and for investment funds, will tend to tighten interest rates and restrict the availability of credit. Similarly, a recession of business activity will normally lead to lower rates, easier terms, and less stringent rationing by lenders. Like fiscal stabilizers, the monetary stabilizers are often useful built-in defenses against recessions or against inflationary excesses of demand. But these defenses may not be strong enough. Being automatic stabilizers, they can only moderate unfavorable developments; they cannot prevent or reverse them. And at other times, unless the monetary authorities offset their effects, they can operate counter to basic policy objectives, braking expansions short of full employment. Discretionary policy is essential, sometimes to reinforce, sometimes to mitigate or overcome, the monetary consequences of short-run fluctuations of economic activity. In addition, discretionary policy must provide the base for expanding liquidity and credit in line with the growing production potential of the economy. For these reasons, the Federal Reserve System is continuously making and executing discretionary monetary policy.

The proper degree of general "tightness" or "easiness" of monetary policy, and the techniques by which the various governmental authorities can appropriately seek to achieve it, depend on the state of the domestic economy, on the fiscal policies of the Government, and on the international economic position. When the economy is in recession or beset by high unemployment and excess capacity, monetary policy should clearly

be expansionary. How expansionary it should be depends very much upon the extent of the stimulus that the government budget is, and will be, giving to over-all demand. When demand is threatening to outrun the economy's production potential, monetary policy should be restrictive. How restrictive it should be depends, again, upon how much of the job of containing inflation is assumed by fiscal policy. There is, in principle, a variety of mixtures of fiscal and monetary policies which can accomplish a given stabilization objective. Choice among them depends upon other objectives and constraints. . . .

In the 1965 Report, the Council pointed out that monetary policy can be retarding as well as expansionary, and that it should be the latter if growth is to be expected (p. 105).

Over the long run, growth of economic activity must be supported by the continued expansion of monetary assets, since individuals and businesses need a growing volume of liquid balances for transaction purposes as their income and spending increase. The need for growth in liquid assets also results from investors' desires to hold some part of their wealth in assets that are readily accessible and free of risk.

Liquid assets can take a variety of forms, and new institutions are continually evolving to meet these needs. During the past thirty years, savings and loan associations and mutual savings banks have come to play an important role as competitors with commercial banks for the time and savings deposits of the public. Similarly, business firms frequently invest short-term funds in Treasury bills and in a wide and growing variety of other "money market" paper. Nevertheless, monetary assets provided by the commercial banking system continue to play a crucial role, since checks drawn on demand deposits constitute the most important medium of exchange for transacting day-to-day business. The growth of liquid assets, and particularly of the money supply, should keep pace with expanding requirements over the long run in order to support growth and economic advance. . . .

Relationship between Fiscal and Monetary Policy

President Johnson outlined the main relationships between fiscal and monetary policy in the 1966 Report (pp. 10–11).

The fiscal program I recommend for 1966 aims at full employment without inflation. It is a responsible program. It recognizes that vigorous private demand and required defense spending could upset the balance of supply and demand so diligently pursued by fiscal and monetary policies in recent years, and now so effectively achieved.

Until this year, pursuit of this balance has pointed fiscal policies toward the stimulation of demand. Now a stimulus is no longer appropriate.

I have reviewed every program of Government to make room for the necessities of defense. I have sharply reduced or eliminated those civilian programs of lowest priority.

But, as I indicated in my State of the Union Message, I am unwilling to declare a moratorium on our progress toward the Great Society. My budget will add $3.2 billion to our war against poverty, ignorance, and disease. Yet savings elsewhere will hold the rise in the Administrative Budget—apart from the added costs of Vietnam—to only $600 million.

Moreover, I am asking the Congress to enact promptly a combination of proposals affecting tax payments in the year ahead:

—a rescheduling of the January 1, 1966 and later excise tax reduction enacted last June for automobiles and telephone service;

—a graduated withholding system that will improve the pay-as-you-go basis of our personal income taxes without increasing tax rates or tax liabilities;

—a corresponding speed-up in payments of corporate income taxes this year and next, also without increasing tax rates or tax liabilities; and

—a method of paying self-employment Social Security taxes on a current basis.

These measures will let us stay close to a high-level balance between the revenues that the Federal Government draws out of the economy and the expenditures that it puts back into the spending stream, and to a high-level balance between total demand and the economy's capacity to produce. It is my judgment that this budget provides the appropriate fiscal environment for the maintenance of basic price stability with continued growth.

I will also look to the Federal Reserve System to provide assistance in promoting the objectives we all share:

—meeting the credit needs of a vigorous and growing economy, while

—preventing excessive credit flows that could carry the pace of expansion beyond prudent speed limits.

Although the 1963 Council Report emphasized the role of fiscal policy, it did not overlook monetary policy (p. 19).

Monetary policy has remained favorable to economic expansion. During 1962, most interest rates on long-term financing fell below their levels at the trough of the recession in February 1961. While this was partly a passive result of economic slack and stability in the price level, it also reflected deliberate effort on the part of the monetary authorities to maintain adequate liquidity and favorable credit conditions.

Monetary and debt management authorities faced a continuous challenge in maintaining such credit conditions without encouraging short-term capital movements that would hinder improvement in the U.S. balance of payments. Since mid-1960, monetary and debt management

authorities have worked together to keep short-term interest rates from falling out of line with rates abroad.

Federal Reserve open market operations were geared to two objectives. First, they provided the basis for deposit expansion as well as restoring to the banking system reserves absorbed by the decline in the gold stock and the rise in currency in circulation. Since the Federal Reserve also reduced cash reserve requirements against savings and time deposits from 5 to 4 percent, the result was an effective net increase in reserves of more than $1 billion during the year.

Second, purchases and sales of U.S. Government securities were designed to minimize the downward pressures on short-term interest rates resulting from monetary expansion, while encouraging the flow of long-term funds and keeping downward pressures on long-term rates needed for domestic recovery and growth. The Federal Reserve System continued the policy, begun in February 1961, of purchasing longer-term securities, although on a more moderate scale in 1962 than in 1961. Most purchases, on balance, were concentrated in the 1–5 year range. There were negligible net purchases of securities with maturities of under 1 year. . . .

That monetary policy is linked closely to fiscal policy was brought out by the Council in its 1963 Report (p. 55), as follows:

Monetary policy as well as debt policy must be coordinated with fiscal policy to secure the objectives of higher employment and growth without inflation. We are now, and for some time still will be, in a situation of substantial slack in labor force and capital resources, a situation in which expansionary policies are required. Even after the proposed tax revision begins to release consumer demand and spur investment, other phases of public policy, including monetary and debt policy, can serve to support the absorption of unused resources. When the economy approaches higher levels of capacity utilization and employment, labor as well as capital markets will tend to tighten, and the policy mix will need to be adjusted to changing circumstances. Public policy thus involves a continuous process of adjustment, and no validity attaches to general rules of "tight" or of "easy" money meant to be valid under all conditions. What matters most at this time is that financial policy should be designed to facilitate rather than retard the expansionary process which the tax program is designed to launch.

The ease or tightness of monetary and credit conditions depends only in part on the supplies of bank reserves and liquid government obligations. It also depends on the balance between these supplies and the economy's demands for money, liquid assets, and credit accommodation. Economic expansion increases these demands. As private income and wealth increase, so do the public's needs for money and liquid assets. Normally, the public will wish to place part of its new saving every year in additional holdings of checking accounts, thrift deposits, and other liquid

assets. Likewise, business requirements for loans to finance inventories and trade credit expand. When unused productive resources are available, it is not inflationary to permit a parallel expansion in the supplies of money and liquid assets and in the availability of bank credit.

On the other hand, it would clearly be a restrictive monetary policy to hold bank reserves constant while the monetary and credit needs of the economy increase. Interest rates would tend to rise, and private borrowers would find it both more expensive and more difficult to obtain bank loans or to float securities in the capital markets. . . .

Fear was expressed in the 1964 Report (p. 11) lest the expansionary effects of fiscal policy might aggravate the balance of international payments problem. Emphasis was placed on monetary policy to act as a rein (pp. 47–48).

Monetary Policy and Balance-of-Payments Measures

A strong upswing in the economy after the tax cut need not bring tight money or high interest rates, especially when

—our balance of payments is improving so sharply in response to measures begun in 1961 and reinforced last July;

—the budget for fiscal year 1965 will cut the Federal deficit in half and ease pressures on interest rates from Treasury borrowing.

It would be self-defeating to cancel the stimulus of tax reduction by tightening money. Monetary and debt policy should be directed toward maintaining interest rates and credit conditions that encourage private investment.

But monetary policy must remain flexible, so that:

—It can quickly shift to the defense if, unexpectedly, inflation threatens or the balance of payments worsens.

—When monetary measures are not needed as defensive shock troops, they can reinforce fiscal policy in promoting domestic expansion. . . .

MONETARY POLICY IN THE PRESENT EXPANSION

The fiscal policy of the 1961–63 years was complemented by a monetary policy designed to encourage an expanding economy while also defending the balance of payments. Actions were taken to raise short-term interest rates and to maintain them at levels that would reduce outflows of funds to money markets abroad. Within the limits established by this policy, the Federal Reserve provided money and bank credit to support the expansion and generally avoided placing upward pressure on long-term rates.

In attempting to pursue both its domestic and its balance-of-payments objectives, the Federal Reserve used its policy instruments flexibly. In February 1961 it began to supply a portion of new bank reserves through the purchase of longer-term securities. Meanwhile the Treasury concen-

trated its new offerings of securities largely in short maturities to exert upward pressure on short-term interest rates. In the autumn of 1962 the Federal Reserve reduced reserve requirements on time and savings deposits, thereby releasing reserves for seasonal growth in money and credit without purchasing short-term securities in the open market.

A particularly important factor that exerted upward pressure on short-term rates but held long-term rates down was the two-step change in Regulation Q in January 1962 and July 1963, which permitted banks to pay higher interest rates on time and savings deposits. These steps accelerated the flow of savings into commercial banks, which in turn invested heavily in mortgages and State and local securities, thereby putting downward pressure on mortgage and other long-term yields. At the same time commercial banks began to issue negotiable time certificates of deposit in substantial quantities, which in effect added to the supply of short-term securities and helped to push up short-term interest rates.

In July 1963 the Federal Reserve increased the discount rate from 3 to 3½ percent, largely to reinforce efforts to raise short-term interest rates for balance-of-payments reasons.

Analysis of the results of Federal Reserve actions on the growth of deposits and bank credit is especially difficult for this expansion period because of the changes in Regulation Q. The recorded growth in money supply—at an average rate of 2.8 percent a year during the expansion—understates the degree to which monetary policy provided a stimulus to the economy, since many business firms and individuals were induced to shift idle balances from demand to time deposits in order to take advantage of the higher interest rates.

On the other hand, the increase in time deposits—at an average rate of 15.2 percent a year—exaggerates the expansionary stimulus from monetary policy. The interest-rate increases on commercial bank time deposits raised their attractiveness relative to direct holdings of securities or deposits at other financial intermediaries. Thus, while bank credit expansion was particularly rapid, part of it reflected lending that otherwise would have occurred through nonbank financial institutions or directly through the securities markets. . . .

Views of the Council of Economic Advisers

The President said little about monetary policy in his 1967 Report, ut the Council emphasized this type of policy as a tool for economic :abilization (pp. 65–68) in its Report.

Uses of Monetary Policy

As a stabilization tool, monetary policy has some distinct advantages. Policy changes can be made quickly in response to changing signals. Furthermore, as was evident in 1966, a restrictive monetary policy can reduce aggregate demand fairly promptly and very sharply.

But there are also distinct limitations on the uses of monetary policy. As demonstrated in 1966 its impact on different sectors of the economy can be highly uneven, both in magnitude and in timing. Moreover, if monetary policy is used repeatedly and in large doses to restrain inflation, it may be difficult to avoid a long-term upward trend in interest rates. And the scope for monetary policy may at times also be limited by balance of payments considerations.

The uneven impact of changes in credit conditions is unavoidable to a certain extent. Monetary policy inevitably has its principal effect on those sectors that are particularly dependent on credit. But the special vulnerability of some sectors to tightening is also importantly related to certain structural characteristics of our financial institutions. Over time, there should be scope for reducing the uneven impact of monetary policy through various modifications in these institutional arrangements. This is particularly true with respect to homebuilding.

In the postwar period, changing monetary conditions have contributed to several major swings in residential construction. This particularly sensitive reaction to monetary conditions reflects the reliance of mortgage financing on institutional rather than open market sources of credit and its special reliance on one particular type of institution, namely savings and loan associations. The most recent example of this sensitivity, reviewed earlier, was in 1966, when the associations suffered major withdrawals of funds.

Until 1957, savings and loan associations were largely sheltered from competition with commercial banks. Bank interest rates for time deposits were fixed at a low level, and most banks were not interested in competing for savings funds. At that time, however, a series of increases was initiated in the administrative ceilings on the interest rates that banks could pay on time deposits. This led to a gradual narrowing in the differential between rates paid by the associations and by the banks; and the share of deposits going into savings and loan associations declined, even though the total amount advanced rapidly, at least until 1966. Given the respective legal limitations on the portfolios of banks and of thrift institutions, such a shift gradually tended to curtail the flow of funds to the mortgage market. There is every reason to believe that thrift institutions will continue to face strong competition from banks, and must hereafter operate in a very different environment from that prior to 1957.

The supply of mortgage funds might be better protected in future periods of tight credit conditions if techniques could be devised to give the mortgage markets new and better forms of access to the open capital markets, either directly or through the thrift institutions. A number of possible arrangements are now under discussion in the industry. With such arrangements, funds would be available only at competitive rates; but they would be available. At present, some access is obtained indirectly, when banks, insurance companies, and savings banks sell bonds in periods of tight money in order to buy mortgages. FNMA secondary

market operations and FHLBB advances to savings and loan associations also provide an indirect link between mortgage financing and the national capital market.

Some additional stability in the flow of funds to the mortgage market could also be achieved through changes in the practices of savings and loan associations. They could partially stabilize their mortgage lending activity in the face of fluctuations in deposit flows if they held secondary reserves as commercial banks normally do. They can also place themselves in a better position to hold on to interest-sensitive deposits in a period of tight credit by issuing special instruments, like CD's, returning a higher yield to investors. Comprehensive authority to issue such instruments has been granted only recently and should be of additional help in the future. In particular, the associations reduce their exposure to abrupt changes in deposit flows by issuing such instruments for longer maturities.

It would also be desirable to strengthen thrift institutions by legislation permitting the Federal chartering of mutual savings banks. Such institutions would have powers to invest in corporate securities and consumer loans as well as mortgages. While broadened investment privileges of federally chartered mutual savings banks might initially divert some funds from the mortgage market, such chartered banks would improve the efficiency of thrift institutions, strengthen them in competition with banks, and thereby ultimately benefit the mortgage market.

If the ability of the thrift institutions to compete with commercial banks can be strengthened, continuous reliance on interest rate ceilings on savings accounts may no longer be desirable. But there could still be occasions when rate ceilings would serve a genuine need. This contingency could be provided for in either of two ways: (1) through standby authority to impose rate ceilings under particular circumstances; or (2) through permanent ceilings set sufficiently high that they would become effective only in unusual instances. Pending agreement on the most suitable form of permanent legislation for regulating rates, the present legislation (which expires in September) should be continued for a limited period.

The kinds of financial innovations sketched above could increase the scope for the active use of monetary policy as a tool of stabilization. With such changes, a restrictive monetary policy might have a broader and less uneven impact.

There are, however, other possible limitations on the use of monetary policy. There is the danger that under some circumstances, employment of the monetary instrument for short-run stabilization purposes can produce an upward ratcheting of interest rates which could interfere with long-term economic growth.

Indeed, in the postwar period, cyclical movements in rates have been superimposed on a distinct upward rate trend. Every period of business expansion has brought new postwar peaks in interest rates. Of course,

rates were abnormally low at the start of the postwar era, reflecting the unusually large liquid balances of businesses and households. But this initial situation cannot explain the continuing upward trend in rates since the mid-1950's. During each period of economic expansion in the 1950's, credit was tightened sharply to restrain demand. The resulting increases in interest rates were not fully offset during the subsequent mild recessions. With each advance, expectations became adjusted to the new level. Rigidities retarded declines, once higher rates were built into the deposit and loan practices of financial institutions.

But an upward ratchet of interest rates is not an inherent or necessary result of a flexible monetary policy. There is now a welcome opportunity for monetary policy to demonstrate its reversibility in a period of prosperity; indeed, that opportunity has already begun to be converted into reality.

A variety of approaches can also be used to reduce some of the obstacles to a flexible use of monetary policy which may be imposed by balance of payments considerations, as discussed more fully in Chapter 5.

Monetary policy is an indispensable tool; and there is important scope for making it more useful. But the measures that can be taken to this end cannot fully overcome its inherent limitations. It needs, and has, a powerful ally in fiscal policy. . . .

strengthen and in the third quarter rose vigorously. Though this expansion was interrupted later in the year by the steel shortage, the value of exports in the 11 months through November was about the same as in the corresponding period of 1958. Imports, which were little affected by the 1957–58 recession, staged an exceptionally rapid increase until mid-1959 and, on a seasonally adjusted basis, remained steady thereafter at a level much higher than in previous years.

These developments in trade were superimposed upon a heavy outflow of capital and military expenditures, though both of these flows, especially that of private capital funds, were smaller in 1959 than in 1958. The transfer of gold and liquid dollar assets resulting from the gap between aggregate payments and receipts reached an annual rate of $4.5 billion in the second quarter of 1959. This rate slackened a little in the third quarter, and there was further improvement in later months, reflecting in part a $250 million advance repayment by the United Kingdom to the Export-Import Bank.

Among the underlying factors that have contributed to the change in the trade and payments position of the United States since the early postwar years have been the steady recovery and growth in the productive capacity of other countries, including the re-establishment of old comparative advantages and the introduction of new technologies. On the side of demand, the pressures on domestic resources which persisted in many countries long after the war have generally subsided. In some cases, new international cost and price disparities may now have developed to the advantage of these other countries, and the depressed level of ocean freight rates since 1957 has facilitated the marketing in the United States of certain foreign products. Much of the change in trade may be attributable, however, to intensified production and export efforts by other countries on the basis of previously existing cost differences.

These influences have not operated exclusively in one direction. A detailed examination by the Department of Commerce of recent changes in the shares of the United States in different export markets for manufactured goods reveals a considerable diversity of trends, with many gains as well as losses. Moreover, the serious contractions have been concentrated in a few items. Among these, automobiles and steel stand out, as they do in the rise in imports.

A review of recent developments in the foreign trade of the United States must also take account of the effect of business fluctuations at home and abroad and of the special circumstances affecting trade in particular products that figure prominently in this country's exports or imports. Thus, the decline of exports after mid-1957 was associated with a general weakening of foreign import demands, aggravated by the reversal of special forces which had contributed (notably in the cases of petroleum, coal, cotton, and wheat) to the earlier upswing. Similarly, the strengthening of exports during 1959 reflects the renewal of economic expansion abroad. . . .

Policies for Reducing the Payments Deficit

To help speed the attainment of a reasonable equilibrium in the United States balance of payments, the Administartion in 1960 intensified policies instituted earlier when the recovery by the once war-devastated nations of their competitive strength had become evident. The effort centered on measures to increase United States exports and to reduce the balance of payments impact of Government military and economic programs abroad in a manner consistent with our responsibilities and long-standing policies. Underlying these steps were equally important policies relating to the domestic economy. Fiscal and monetary policies had as one of their major objectives the maintenance of confidence in the dollar as a sound and reliable currency. In this connection, the Administration continued to emphasize the importance of appropriate action by management and labor to insure the competitiveness of United States goods at home and abroad.

To support the efforts of private business in enlarging sales abroad, the Federal Government, with the cooperation of private business, instituted early in 1960 a National Export Expansion Program—a series of coordinated measures to improve and expand Government services in private industry. Measures were adopted to gain the help of existing national and local business groups, to assist and encourage businessmen newly entering the export field, and to strengthen contacts with business groups abroad. To place United States exporters on a more equal basis with exporters in other industrial countries, the Export-Import Bank short-term credits and expanded its existing facilities for medium-term export credits and guarantees. The United States also continued to urge other countries—particularly the economically and financially strong ones—to eliminate remaining discriminatory restrictions on United States goods and services and to lower tariffs and other barriers to trade.

Toward the end of the year, the United States initiated a number of coordinated measures designed to obtain substantial foreign exchange savings in its Government expenditures abroad without reducing its military strength or impairing its international commitments. Steps were formulated to reduce gradually and then limit the number of dependents abroad of Defense Department personnel, particularly in the highly industrialized countries with strong currencies, and to cut back Defense Department procurement of foreign goods and services and other expenditures abroad. Other departments and agencies which have personnel abroad and which engage in procurement abroad were instructed to institute similar programs. In addition, the question af the cost of the United States troops in Germany came under discussion by the United States and German Governments. To minimize the balance of payments effects of our economic aid programs, the International Cooperation Administration was instructed to place primary emphasis on financing goods and services of United States origin in all of its foreign aid activities,

and as far as practicable to discontinue offshore procurement in 19 countries with strong currencies. Similarly, the Development Loan Fund, which had adopted a similar policy in October 1959, was instructed to reduce procurement outside of the United States to the lowest possible figure.

In addition, efforts were increased to ensure that sales under the agricultural surplus disposal and related programs do not reduce cash dollar sales of United States products. International institutions were urged to use currencies other than dollars as fully as possible, and other strong countries were encouraged to permit borrowing in their capital markets by these institutions and by other borrowers, where appropriate. On January 14, the regulations that have been in force for a number of years prohibiting the holding of gold in the United States were uniformly extended to holdings of gold abroad by persons and business organizations subject to the jurisdiction of the United States.

International Economic Policies

Most countries continued in 1960 to move toward the free and multilateral trade and payments system which has been the goal of the United States since the end of the war and for which the United States has pressed with particular vigor in the last few years. By now, discrimination against United States exports has diminished very substantially; the major remaining quantitative trade restrictions on United States exports are against agricultural products, particularly in Western Europe. Foreign restrictions on capital transactions, however, continue to be considerable. The United States Government expects that there will be continued progress in the dismantling of restrictions on world trade and payments. In particular, the great economic strength of the countries belonging to the European Economic Community and the European Free Trade Association should facilitate a significant lowering of tariff barriers during the forthcoming Geneva GATT negotiations.

The institutional framework of world finance was improved in 1960 through the establishment of the International Development Association and the Inter-American Development Bank. The United States announced new aid programs for Latin America, and further advances were made in the area of *ad hoc* multilateral cooperative efforts for development, most notably the Indus River Basin project.

The United States continued to stress the need for a strengthened determination by all the industrial countries to share in providing funds to the less developed parts of the free world. At the initiative of the United States, the major industrial countries early in 1960 formed a Development Assistance Group to discuss methods for providing such aid. It is planned to incorporate the work of this group in the Organization for Economic Cooperation and Development (OECD), the successor organization to the Organization for European Economic Cooperation (OEEC), which is scheduled to come into existence in 1961, following

ratification of its convention, and which is to comprise the 18 Western European members of the reconstituted OEEC together with Canada and the United States. The objectives of this organization will be to achieve the highest sustainable economic growth in member countries, to contribute to sound economic expansion in countries in the process of development, and to contribute to the expansion of world trade.

Along with these advances, the problem of shifts of short-term funds from one international center to another came to the fore during 1960. Now that freedom for international short-term capital movements has been substantially enlarged, and the economies of the major countries abroad have been greatly strengthened, it appears that interest rate considerations may have an increasing influence on short-term capital flows. However, the international financial mechanism today seems strong and flexible enough to allow solutions to the resulting difficulties to be worked out.

International payments, other than short-term capital movements, also have continued to show an imbalance. As a result of this over-all lack of balance in world payments, the substantial increases of international reserves of recent years continued to be concentrated in a small number of countries, particularly in continental Europe. Originally, this inflow was justified by the extremely low level of reserves of these war-devastated countries, but today the reserves of most of them, by and large, seem ample.

The United States has many responsibilities in the world economy. These include keeping the dollar strong, in view of its key role in international trade and payments, maintaining liberal commercial relationships with other countries, contributing to the defense of the free world, and supplying a share of the capital resources needed by less developed countries. The United States can meet these responsibilities because of its resourceful and flexible economy and its international reserves which, with an available gold stock of about $17½ billion, are large. But the United States cannot play its part fully unless other industrialized nations pursue policies required by their positions in the world economy. This fact is now increasingly recognized. A helpful start has been made in the sharing of development costs and other burdens and in the cooperative reduction of existing payments imbalances, but further efforts are needed if the international financial mechanism is to work properly and the free world's economy is to move ahead steadily. . . .

Recommendations in the National Economic Report of 1962

The 1962 Report examined the status of the balance of payments, nd suggested a series of proposals aimed at reversing the deficit trend, ncluding an expansion of exports, a stable domestic price level, the development of controls over foreign investment, an economy in governmental (primarily military) expeditures abroad, and the strengthening of the international monetary system (pp. 13–16).

Balance of Payments

The program launched last year to reduce our payments deficit and maintain confidence in the dollar will, I am sure, show further results in 1962. I am hopeful that the target of reasonable equilibrium in our international payments can be achieved within the next two years; but this will require a determined effort on the part of all of us—government, business and labor. This effort must proceed on a number of fronts.

Export expansion. An increase in the U.S. trade surplus is of the first importance. If we are to meet our international responsibilities, we must increase exports more rapidly than the increase in imports which accompanies our economic growth.

Our efforts to raise exports urgently require that we negotiate a reduction in the tariff of the European Common Market. I shall shortly transmit to the Congress a special message elaborating the details of the proposed Trade Expansion Act of 1962 and explaining why I believe that a new trade policy initiative is imperative this year.

To encourage American businessmen to become more export-minded, we have inaugurated a new export insurance program under the leadership of the Export-Import Bank, and we have stepped up our export promotion drive by improving the commercial services abroad of the U.S. Government, establishing trade centers abroad, planning trade fairs, improving the trade mission program, and working with business firms on export opportunities through field offices of the Department of Commerce and the Small Business Administration. Foreign travel to the United States, which returns dollars to our shores, is now being promoted through the first Federal agency ever created for this purpose.

Prices and productivity. Our export drive will founder if we cannot keep our prices competitive in world markets. Though our recent price performance has been excellent, the improving economic climate of 1962 will test anew the statesmanship of our business and labor leaders. I believe that they will pass the test: our Nation today possesses a new understanding of the vital link between our level of prices and our balance of payments.

In the long run, the competitive position of U.S. industry depends on a sustained and rapid advance in productivity. In this, the interests of economic recovery, long-run growth, and the strength of the dollar coincide. Modernization and expansion of our industrial plant will accelerate the advance of productivity.

Foreign investment. To place controls over the flow of private American capital abroad would be contrary to our traditions and our economic interests. But neither is there justification for special tax incentives which stimulate the flow of U.S. investment to countries now strong and economically developed, and I again urge the elimination of these special incentives.

The new foreign trade program which I am proposing to the Congress will help to reduce another artificial incentive to U.S. firms to invest

abroad. The European Common Market has attracted American capital, partly because American businessmen fear that they will be unable to compete in the growing European market unless they build plants behind the common tariff wall. We must negotiate down the barriers to trade between the two great continental markets, so that the exports of our industry and agriculture can have full opportunity to compete in Europe.

Governmental expenditures abroad. Military expenditures form by far the greater part of our governmental outlays abroad. We are discussing with certain of our European allies the extent to which they can increase their own military procurement from the United States to offset our dollar expenditures there. As a result, the net cost to our balance of payments is expected to be reduced during the coming year, in spite of increased deployment of forces abroad because of the Berlin situation.

To curtail our foreign aid programs in order to strengthen our balance of payments would be to sacrifice more than we gain. But we can cut back on the foreign currency costs of our aid programs, and thus reduce the burden on our balance of payments. A large percentage of our foreign aid is already spent for procurement in the United States; this proportion will rise as our tightened procurement procedures become increasingly effective.

We have sought to induce other advanced countries to undertake a larger share of the foreign aid effort. We will continue our efforts through the Development Assistance Committee of the Organization for Economic Cooperation and Development to obtain a higher level of economic assistance by other industrial nations to the less developed countries.

Short-term capital movements. Outflows of volatile short-term funds added to the pressures on the dollar in 1960. Our policies in 1961 have diminished the dangers of disruptive movements of short-term capital. For the first time in a generation, the Treasury is helping to stabilize the dollar by operations in the international exchange markets. The Federal Reserve and the Treasury, in administering their monetary policy and debt management responsibilities, have sought to meet the needs of domestic recovery in ways which would not lead to outflows of short-term capital.

During the past year, we have consulted periodically with our principal financial partners, both bilaterally and within the framework of the OECD. These consultations have led to close cooperation among fiscal and monetary authorities in a common effort to prevent disruptive currency movements.

Strengthening the international monetary system. The International Monetary Fund is playing an increasingly important role in preserving international monetary stability. The reserve strength behind the dollar includes our drawing rights on the Fund, of which $1.7 billion is automatically available under current practices of the Fund. An additional $4.1 billion could become available under Fund policies, insofar as the

Fund has available resources in gold and usable foreign currencies. Recently, the Fund has diversified its use of currencies in meeting drawings by member countries, relying less heavily on dollars and more heavily on the currencies of countries with payments surpluses. However, the Fund's regular holdings of the currencies of some important industrial countries are not adequate to meet potential demands for them.

In a message to the Congress last February, I said: "We must now, in cooperation with other lending countries, begin to consider ways in which international monetary institutions—especially the International Monetary Fund—can be strengthened and more effectively utilized, both in furnishing needed increases in reserves, and in providing the flexibility required to support a healthy and growing world economy."

We have now taken an important step in this direction. Agreement has been reached among ten of the major industrial countries to lend to the Fund specified amounts of their currencies when necessary to cope with or forestall pressures which may impair the international monetary system. These stand-by facilities of $6 billion will be a major defense against international monetary speculation and will powerfully reinforce the effectiveness of the Fund. They will provide resources to make our drawing rights in the Fund effective, should we need to use them. Moreover, the U.S. stand-by commitment of $2 billion will augment the resources potentially available through the Fund to other participants in the agreement, when our balance of payments and reserve positions are strong. I shall shortly submit a request to Congress for appropriate enabling legislation. . . .

Views of the Council of Economic Advisers, 1963

The continued unfavorable balance of payments received special attention by the Council in 1963. In addition, the Council elaborated on the importance of the United States in the world economy (pp. 91–93), the impact on the world of domestic expansion in the United States (pp. 98), and the effects of domestic expansion on the world competitive position of the United States (pp. 103–104).

THE UNITED STATES AND THE INTERNATIONAL ECONOMY

The international economy has undergone a remarkable transformation in the past decade. For many years after World War II, import quotas, discriminatory trade practices, and exchange restrictions on all forms of international payments characterized the bulk of international transactions. Though further progress needs to be made, much of this restrictive legacy has now been swept away. This transformation culminated in the formal acceptance by the major European countries in early 1961 of the currency convertibility requirements of the Interna-

tional Monetary Fund. It is a notable achievement and has far-reaching implications for the U.S. economy and U.S. economic policy.

Among the factors facilitating this development has been a massive redistribution of the world's gold and foreign exchange reserves. At the end of 1948, the United States held 71 percent of the free world's monetary gold stock; by June 1962, the U.S. share had fallen to 40 percent. During the same period, Western Europe's share grew from 15 percent to 44 percent. In addition, foreign official holdings of liquid dollar assets rose by nearly $9 billion. This redistribution ended the excessive concentration of reserves which had been brought about by the political upheavals in Europe in the 1930's, World War II, and the requirements of postwar reconstruction. In achieving balance of payments surpluses which ebuilt reserves, continental European countries gained greater freedom f action to promote economic expansion and to reduce restrictions on nternational transactions.

The redistribution of reserves was brought about partly through defiits in the international payments of the United States, which led to large ransfers of gold and liquid dollar assets to Europe. These U.S. payments eficits have persisted beyond the point where they improve the distribuon of the world's monetary reserves. Indeed, continuing large payments eficits by the United States could create doubts about the stability of ie dollar and threaten the efficient operation of the international payients system. As a result, the U.S. Government has had to pay close and onstant attention to the net financial outcome of its transactions, and iose of its citizens, with the rest of the world. Important measures have een taken to improve the payments position of the United States, and omestic economic policy has been framed with attention to the balance f payments and the position of the dollar. International transactions of ie United States are discussed in the first section of this chapter.

The relaxation of many restrictions on trade and payments and the edistribution of world reserves have not been the only factors transorming the world economy. The progress of the European Economic Community (EEC) toward a rapidly growing, unified, tariff-free market ncompassing six European countries—and possible more in the future—as already profoundly altered world economic relationships. The EEC ffers a domestic market broadly comparable to the United States and n import market even larger. Liberal access to this market will be vital) future foreign trade; exclusion by restrictive import tariffs or other arriers could seriously affect the trade and economic development of iany countries of the free world. The emerging EEC and the relationship f the United States to it are discussed in the second section of this hapter.

It is now generally acknowledged that the responsibility of the indusial nations for providing capital and technical knowledge to other ountries for economic development requires more than the occasional nd sporadic efforts made before the mid-1950's. Systematic economic evelopment of the low-income parts of the free world—within a span

of time that is very short by historical standards—has become a major objective of western foreign policy. Carrying out this gigantic task will require considerable transfers of capital and technical skill. It will result in large shifts in the structure of world production and trade, and will require substantial adjustments in both advanced and developing countries. Some of these problems are discussed in the third section of this chapter.

These developments have one common characteristic: they bring countries economically closer together. They tend to integrate the free world economy. Markets will become more unified, competition will be keener, and differences among nations in techniques of production will diminish. Substantial progress toward our foreign economic objectives will be made, but new challenges for economic policy, national and international, will arise. Some of these problems and recent efforts to find solutions are discussed in the final section of this chapter.

U.S. INTERNATIONAL TRANSACTIONS

THE UNITED STATES AS WORLD TRADER, INVESTOR, AND BANKER

The United States is by far the largest producing nation in the world, accounting for more than 40 percent of total industrial production of the free world. Its 188 million inhabitants place it fourth among nations in population, and its unequalled level of per capita income makes it the world's largest domestic market and largest source of savings.

As trader

The basic purpose of our foreign trade is to exchange goods produced efficiently in the United States for goods which we can produce relatively less efficiently or not at all. International trade lowers costs and raises standards of living both at home and abroad. Foreign trade accounts for a much larger part of transactions of the U.S. economy than is generally appreciated. Even though our merchandise exports are only about 4 percent of total gross national product (GNP), they amount on nearly 9 percent of our total production of movable goods. For some products, overseas demand is exceptionally important; it provides over half the market for such diverse U.S. products as rice, DDT, and tracklaying tractors. Imports by the United States provide materials essential for production and also permit Americans variety and diversity in their consumption. Crucial products like nickel and cobalt come almost entirely from foreign sources.

U.S. exports and imports are a major part of world trade. In the first three quarters of 1962, U.S. merchandise imports were nearly 14 percent of total world imports. For some countries and some commodities, of course, the U.S. market is far more important than this average share implies. For example, U.S. coffee imports are usually over half of total world imports of coffee. . . .

payments surpluses in Europe, while 5 years of economic slack have not eliminated the U.S. payments deficit.

Any doubts on this score should be resolved by a consideration which far transcends mechanical estimates of balance of payments effects. Long-run confidence in the dollar as an international currency, and therefore in the international payments system in which the dollar plays a central role, depends on underlying confidence in the American economy—on its ability to produce efficiently, to use its vast resources fully, and to grow without inflation.

The American economy is still the ultimate example—the showcase—of free enterprise in action. A sluggish American economy will raise doubts everywhere, and especially in the newly developing nations, about the ability of a free enterprise economy to perform efficiently and to grow continuously. Full utilization and economic growth in the United States are of critical importance to the less developed countries in one further respect. These countries cannot develop without an increasing demand from abroad for their products. They cannot diversify their economies without export markets for their new products—especially light manufactures. Full utilization and full employment in the United States will not only raise U.S. demand for these imports, but will also—by permitting labor, capital, and enterprise to adjust more readily to changing patterns of supply and demand—make it easier to accept imports of light manufactures even when they compete with domestic production.

COMPETITIVENESS OF U.S. PRODUCTS

If full employment and rapid growth are to improve the balance of payments, there is one crucial requirement. The competitiveness of U.S. products must continue to improve. Export competitiveness has many dimensions, including price, credit availability, product design, timing of delivery, sales and distribution outlets, and servicing facilities. Strengthening the U.S. export position therefore requires a broadly gauged program.

In the past two years, the Department of Commerce has launched an export drive to inform potential U.S. exporters about sources of foreign demand and to acquaint U.S. manufacturers with foreign requirements. Details of the National Export Expansion program are given in Appendix A. In July 1962, a National Export Expansion Coordinator was appointed by the President to oversee and coordinate the many aspects of the export promotion program. The Department of Agriculture, in cooperation with private trade groups, has under way an extensive export promotion program directed at expanding foreign dollar markets for U.S. food and agricultural products. More than 40 agriculture and trade groups cooperate with the Foreign Agricultural Service in carrying out this program. In addition, as described in Appendix A, the Export-Import Bank has greatly improved its export credit programs and has instituted a new

credit insurance program to bring the credit facilities available to U.S. exporters closer into line with those available to European exporters. While these export credits defer receipts from foreign importers to a later date, the enlarged exports serve to interest foreigners in American products and Americans in foreign markets.

A key element in competitiveness is price. If we want to sell more abroad, we cannot allow our prices—and particularly the prices of our exports—to rise relative to those of our major foreign competitors. . . .

The Trade Expansion Act of 1962

As part of the United States attempt to lessen its unfavorable balance of payments the Trade Expansion Act of 1962 was passed to help promote United States exports. The importance of this measure was discussed in the 1963 Report (pp. 113–115).

The Trade Expansion Act

The whole free world can benefit from removal of age-old national barriers to the full utilization of Europe's productive strength. But the nations of the free world, both within and outside the EEC, must assure that the EEC uses its new power, not as a lever to secure gains for its members at the expense of nonmembers or for some of its producers at the expense of others, but as an engine to promote economic progress and cooperation throughout the world.

The Trade Expansion Act of 1962, signed by President Kennedy in October, is designed to meet this challenge by enabling the United States to bargain more effectively and comprehensively. The tariff reducing authority provided by the Act (outlined in Appendix A) greatly increases U.S. flexibility in tariff negotiations, particularly in negotiations with the EEC. If the United Kingdom becomes a member of the Community, the special authority to negotiate tariff reductions greater than 50 percent with the expanded EEC on goods for which the United States and the EEC together furnish 80 percent or more of world exports would apply to a wide variety of products, including coal, organic chemicals, transportation equipment, most kinds of machinery, photographic supplies, paints, cosmetics, and miscellaneous chemical products. In 1960, free world exports of those goods to which the special authority would apply amounted to some $22.5 billion; of this total, exports from the United States were $8.8 billion. Those from EEC countries plus present applicants were $10.4 billion. The United States and the EEC as presently constituted accounted in 1960 for 80 percent of world exports in only two commodity groups: aircraft, and margarine and shortenings.

It will not be easy for the United States and the EEC to reach a tariff agreement of the comprehensive scope that is essential. But both sides

realize the importance of providing a liberal framework for world trade. Since any tariff reductions negotiated by the United States, the EEC, and other participants will be extended to other free world nations on a most-favored-nation basis, these trade negotiations will contribute to a general expansion of free world trade. This extension of tariff reductions to other countries gives them a direct interest in the success of trade negotiations under the Trade Expansion Act. General tariff reductions should benefit all nations, including those exporting products in competition with the exports of former African colonies which now have preferred access to the EEC market. Negotiations under the special authority will also benefit major industrial nations such as Canada and Japan—the two largest trading partners of the United States. To achieve maximum success in tariff reduction, full participation of all major trading nations in the forthcoming negotiations will be essential.

Since trade in many important agricultural products is restricted not only by tariffs but also by quotas and other barriers, negotiations concerning agricultural trade are likely to prove especially complicated and difficult. Both the EEC and the United States may have to make concessions that will be painful to some producers in each area. With the help of the bargaining authority given by the Trade Expansion Act of 1962, the United States hopes to obtain substantial liberalization of trade in agricultural products and to avoid, in the long run, any unfavorable net impact of EEC agricultural policies on U.S. agricultural exports. Some short-run U.S.-EEC understandings along these lines have already been reached. In particular, the EEC has agreed that, if the common policy for grains should result in a reduction in trade in higher quality wheat, corrective action will be taken to restore historical relationships. Also, during the last GATT round of tariff reductions, the United States received important concessions on several agricultural commodities, including cotton and soybeans. The EEC has agreed to negotiate further on trade access for ordinary wheat, corn, grain sorghum, rice, and poultry, and to reconsider during the next general round of negotiations the high external tariffs for tobacco and vegetable oils.

These understandings, stemming from the tariff negotiations concluded in early 1962, are limited and do not themselves assure access for U.S. exports that compete with domestic EEC production. However, they point toward rather than away from liberalization. In contrast, the early actions implementing the Common Agricultural Policy indicate a trend toward increased protection. It would be unfortunate if this trend were not reversed. The reversal will be painful to some EEC producers who have envisaged the Community as an assured market for their products, but will be in the general interest of EEC consumers.

In return for assurances that the EEC will set prices at levels which will allow efficient exporters continued access to their markets, the United States may have to limit its own export subsidy program and subject its

own domestic price policies to international review. U.S. agricultural policies and programs, like those of other agricultural exporting countries, will be subject to close examination and our waiver in the GATT, permitting us to restrict agricultural imports under certain specific conditions, is likely to come under increasing criticism.

Quantitative restrictions, prohibitive import duties, and subsidies are out of place in the world which both the United States and other industrial nations are trying to build. They do not meet the long-run needs of producers and consumers in these developed countries; they restrict mutually advantageous trade; and they are unfair handicaps to the developing countries in other continents. . . .

Development Assistance and Trade Expansion

Increased attention was given in the 1964 Report to the issues of development assistance and trade expansion (p. 12) as follows:

The Kennedy Round. The United States' 30-year campaign to reduce barriers to world trade—and the intensified pursuit of that goal signalled by the passage of the Trade Expansion Act of 1962—will reach a climax in 1964.

U.S. industry and agriculture are in excellent condition to seize the new opportunities offered by trade liberalization and to weather the adjustments that may be required.

Our goal is a more prosperous America in a more prosperous world.

The developing countries. Reduced trade barriers will expand exports and help an increasing number of developing countries to become self-supporting.

But for most poorer countries full self-support is still some distance off. We must help them find a path to development through freedom—and freedom through development.

Our development assistance effort must and will be more sharply focused and rigorously administered. We shall encourage others to share more of its burden and seek a larger role for private investment. But a strong development assistance program continues to be vital to our pursuit of peace and stability in the free world.

Views of the Council of Economic Advisers, 1964

Concern over the balance-of-payments situation continued to be expressed by the Council in 1964 as it reviewed the nature of the balance of payments problem (pp. 121–123).

Since one of the major factors in the balance of payments reflects foreign aid, policies concerning foreign aid were discussed in the 1964 Report (149–150).

THE BALANCE OF PAYMENTS AND THE INTERNATIONAL MONETARY SYSTEM

The United States occupies a unique position in the world economy. It provides the largest national source of exports, the largest market for imports, and the largest source of savings for investment abroad. It undertakes substantial military expenditures abroad and has a large foreign aid program. Its currency, the dollar, is widely used as a means of exchange—in transactions among foreign countries as well as with the United States—and as a store of value in foreign private balances and official monetary reserves. As a consequence, U.S. economic policy, at home and abroad, has special importance to the rest of the world.

The diverse international transactions of the United States—as trader, as investor, and as banker—are summarized in the U.S. balance-of-payments accounts. In recent years, the U.S. accounts have shown an undesirably large deficit, while other countries—especially in Continental Western Europe—have had undesirably large surpluses. The first part of this chapter reviews recent developments in the U.S. balance of payments and discusses the policies—notably those included in President Kennedy's July message—that have been adopted and have begun to improve our international financial position.

A declining U.S. payments deficit will affect the functioning of the international monetary system, since this deficit has been a major source of growth in world monetary reserves. Moreover, the large volume of outstanding short-term liabilities to foreigners, if combined with continued large U.S. deficits, could raise questions about the effective working and continued stability of the system. To examine this and related long-term questions, the leading industrial countries have undertaken a study of the international monetary system. The problems with which that study is concerned are discussed in the second part of this chapter.

THE BALANCE OF PAYMENTS: DEVELOPMENTS, POLICIES, AND OUTLOOK

Between 1950 and 1957, the United States sold $1¾ billion of gold and incurred $8¼ billion in liquid liabilities to foreigners. These transfers of gold and dollars, through payments deficits averaging $1.3 billion a year, made a welcome contribution to replenishing the international monetary reserves of other countries. Since 1957, however, the annual deficits, before taking into account special governmental transactions, have been in the range of $3 to $4 billion, and the additions to the dollar reserves of some surplus countries in Western Europe have tended to exceed the amounts that those countries regard as necessary or desirable. In the 6 years since 1957, U.S. gold sales have amounted to about $7½ billion—of which $5 billion occurred during the 3 years, 1958–60—and liquid dollar liabilities to foreigners have increased about $8¼ billion.

In these circumstances the United States has adopted policies designed

to bring its external accounts into equilibrium, to minimize its loss of gold, and to protect the dollar from possible speculative attack. At the same time domestic policies designed to achieve high employment and more rapid economic growth have been framed with a view to reinforcing the specific balance-of-payments measures.

THE NATURE OF THE BALANCE-OF-PAYMENTS PROBLEM

The U.S. balance-of-payments problem does not reflect any over-all tendency for the United States to "live beyond its means." Americans collectively do not spend more than their real incomes permit and therefore do not absorb goods and services, on balance, from the rest of the world. On the contrary, the United States earns a large surplus on commercial account—that is, its exports of goods and services exceed its imports. The deficit in its external accounts arises from the fact that the United States transfers abroad—through military expenditures, foreign assistance, and private capital movements—a sum of dollars larger than the surplus on goods and services. This excess of dollar payments measures the "deficit on regular transactions." In recent years, as discussed below, the transfer of gold and liquid dollar balances abroad has been less than the deficit on regular transactions, as the result of a number of special transactions undertaken in cooperation with European surplus countries.

The United States deficit does not reflect a reduction in net worth in relation to the rest of the world. In fact, U.S. assets abroad—in the form of private equity investment, short- and long-term credits, and government loans—have in general been increasing faster than U.S. liabilities. The U.S. deficit does reflect a loss of liquidity in the form of a reduction in gold reserves and a build-up of liquid liabilities to foreigners. This way of characterizing the imbalance in the U.S. payments position does not lessen the urgency of correcting it.

As it takes steps to restore equilibrium in its external accounts, the United States must perforce be conscious of these major considerations:

1. Its actions to correct the balance-of-payments problem need to be consistent with its domestic objectives; a healthy domestic economy is important not only to Americans but also to the rest of the world.

2. The United States carries heavy responsibilities for the military security and the economic development of the countries of the free world. These responsibilities should not be compromised by measures taken to improve our payments position.

3. In adopting measures to cope with the balance of payments, the United States should avoid any lapse in the effort, in which other free world countries join, to reduce barriers to international transactions.

4. Finally, in formulating policies it must recognize that the several components of its balance of payments are interrelated. For example, a reduction in capital outflows or foreign aid would reduce the deficit only to the extent that it did not also cause a fall in exports. Similarly, a reduc-

tion (or slower increase) in imports would improve our payments position only to the extent that it did not cause other countries to buy less from us. . . .

U.S. ASSISTANCE OF ECONOMIC DEVELOPMENT OVERSEAS

Much of the world in which the United States conducts its economic affairs consists of poor countries now urgently striving to modernize and develop their economic systems. Our economic relations with these countries constitute a major aspect of U.S. foreign policy, and they interact with our domestic economic performance and programs. Because of the sharp debate over the U.S. foreign aid program that was mounted during the past year and still goes on, this is a particularly appropriate time for reviewing our economic relationships with these less developed countries.

Even if there were no other reasons, the sheer size of the United States would give our economic performance and policies a particular significance for the developing nations. These nations depend heavily on American savings as a major source of capital; on American science, technology, and management as a major source of productive and organizational technique; and on American markets as a major source of demand. Rapid growth and prosperity in the United States make an important contribution to establishing favorable conditions for economic development abroad.

A great variety of American activities—by U.S. businesses, consumers, tourists, and private nonprofit institutions, as well as Government—significantly affect the developing countries, and these activities reflect a variety of purposes. The focus of this chapter, however, is on the economic policies of the U.S. Government toward the developing countries.

Evolution and Rationale

In common usage "foreign aid" refers to transfers on concessionary terms of goods, services, or purchasing power from one government to another, either directly or through the medium of international organizations. (Frequently, although the relations between sovereign nations require that it be agreeable to the recipient government, aid is destined for specific private uses. Also the term "foreign aid" sometimes is extended to foreign transfers by private nonprofit institutions.) While all such governmental transfers are intended to serve the general foreign policy interests of the donor country, the aid mechanism is a vehicle that can be adapted—and has been adapted by the United States—to many specific uses that vary over time and from place to place. For example, arms shipments coupled with military training have been supplied to nations directly threatened by a foreign power hostile to our interests, but such programs may not be appropriate in other situations.

"Development assistance" is only one type of foreign aid. But it is a type that, while guided by the basic criterion of our foreign policy inter-

ests, is properly based on economic analysis and evaluated in concrete economic terms. This chapter will deal primarily with this type of foreign aid, rather than with programs that are of necessity dominated by political or military considerations of a tactical nature. All the same, it is well to recognize that assistance can evolve from one form to another within the same administrative framework—as the cases of Greece and Taiwan, for example, well illustrate. Since our early aid efforts in these nations were responses to military crises, internal and external, longer-run economic development considerations properly took a subsidiary position. Both countries soon gained a measure of internal security and political stability. Our interests, as well as theirs, then dictated embarking on a program of long-run economic development.

SHIFTING POLICY GOALS

American aid commitments during the early postwar period had short time horizons. The Marshall Plan and its various instrumentalities were a response to the postwar economic chaos and were designed to tide highly industrialized nations over a reconstruction period. The Marshall Plan succeeded handsomely and ended ahead of schedule.

Meanwhile, the social, political, and economic revolution sweeping the underdeveloped world was beginning to give our aid program a new focus. Throughout much of Asia, Africa, and Latin America, rising economic expectations coincided with the disintegration of traditional colonial empires and the emergence of independent but inexperienced and vulnerable nations. Their desire for the benefits of the Industrial Revolution was not matched by the skills, the social and political traditions, and the capital required for an industrial economy.

Our initial response was President Truman's Point IV Program of technical assistance. Barely had his proposal been acted upon, however, when the Communists in mid-1950 invaded the Republic of Korea—highlighting the vulnerability of the emerging nations to military attack and their need for more than technical assistance or capital for development projects. For the next few years, reinforcement of the military strength of the free world received primary attention from American policymakers. . . .

Amelioration of Balance-of-Payments Deficit

The 1965 Report elaborated on policies designed to ameliorate the balance-of-payments deficit (pp. 13 and 70–73). Note that it covered much the same ground as the prior reports.

Continued cost and price stability is fundamental to correction of our balance of payments deficit—it is the foundation on which we must build our entire effort to achieve external equilibrium. In addition, we must continue and intensify more specific attacks on the problem.

- We are continuously reviewing our aid and defense programs to achieve the maximum savings in dollar expenditures abroad. Our aid programs must remain closely tied to exports of U.S. goods and services, until the balance of payments problem has been eliminated.
- We must continue and strengthen measures to promote U.S. exports.
- We will be alert to restrain any persistent outflow of short-term private funds in response to relatively high short-term interest rates in foreign countries.
- To increase our ability to attract foreign investment in U.S. securities, legislation will be proposed to improve the tax treatment of such investments.

More broadly, we need to reassess the adequacy of existing programs to deal with the balance of payments problem. . . .

During the past four years, the external payments position of the United States improved. For most of 1964, the balance of payments deficit on regular transactions ran at an average annual rate of little more than half the $3.9 billion recorded in 1960. However, while the improvement was substantial and occurred during a period when the U.S. domestic economy enjoyed strong and sustained expansion, it is by no means enough. Moreover, it now appears that an unusual combination of factors resulted in a sizable rise in the deficit during the fourth quarter. Thus, the balance of payments continues to require serious attention.

When the Kennedy-Johnson Administration took office in early 1961, the United States had just experienced its third successive year of large payments deficits. Such deficits did not mean that the country was "living beyond its means" in terms of its use of resources or that the wealth position of the United States was impaired, for our exports of goods and services were substantially in excess of our imports and our total assets abroad were rising faster than our liabilities. The deficit did, however, represent a decline in net U.S. liquidity that could not be permitted to persist, particularly in view of the special role of the dollar as a major reserve currency. There were indications, moreover, that the underlying competitive position of U.S. export products had been deteriorating for a number of years, suggesting possible further increases in the payments deficit. And in late 1960, international currency markets had become unsettled as speculative outflows of short-term dollar funds increased and the price of gold on the London gold market rose sharply.

The need for action to improve the U.S. external balance was thus readily apparent. At the same time, however, doubts were being widely expressed that an improvement in the payments position would be feasible if the new Administration were to pursue its announced goal of renewing economic expansion. Indeed, the view was widely held that the rise in imports normally associated with economic expansion would necessarily worsen our international accounts.

This view was rejected by the Administration. Instead, policies were based on a fundamental conviction that sound growth of the domestic economy was compatible with longer-run improvement in the balance of payments. Only a strong, resilient, and dynamic economy, characterized by reasonable price stability, would permit the gains in productivity and provide the spur to innovation needed for an underlying improvement in our international competitive position. Moreover, a vigorous and dynamic U.S. economy could be an attractive magnet for private investment funds, thereby leading to an improvement in the U.S. capital account. While maintenance of the dollar as a strong reserve and trading currency required that major attention be given to the balance of payments, it was recognized that the strength of the dollar depends fundamentally on the continued vigor of the American economy in a setting of stable prices.

It was clear, however, that economic expansion alone could not bring about the needed improvement in our external position, particularly in view of continuing U.S. commitments for the defense of the free world and assistance to the developing countries. An array of special policy measures was thus required to permit simultaneous progress toward domestic expansion and external balance, in ways that would minimize any conflict with the basic longer-range U.S. goal of growing freedom in world trade and payments. Only a flexible and imaginative combination of a wide range of policy instruments could serve these purposes.

The various actions taken to raise domestic demand and to adapt monetary policy to the dual requirements of external balance and domestic expansion have been discussed above. Other measures taken in 1961 and 1962 and reinforced in mid-1963 included more direct efforts to stimulate exports, to reduce the Government's contribution to the payments deficit through its overseas expenditures, to reduce outflows of private capital, and to moderate the growth of tourist outlays abroad. New techniques were devised for financing the deficit in ways that would minimize gold outflows and strengthen confidence in the dollar. In addition, increased cooperation among financial and economic authorities here and abroad help to strengthen the defense of international currencies against speculative attacks.

The record of the past four years has demonstrated the essential validity of this approach. While imports of goods and nonmilitary services did, in fact, rise by about $5 billion, in line with the expansion of the domestic product between 1960 and 1964, exports of goods and services (excluding exports financed by the Government and including earnings on investments abroad) increased by nearly $7½ billion. Gross outflows of Government capital have continued to rise moderately, but the net impact of all Government programs on the payments deficit has been reduced by about $1.1 billion. The over-all improvement in the balance of payments attributable to these various factors approaches the total payments deficit in 1960.

Despite these gains, the decline in the deficit has been less rapid than

had been hoped in 1961. The principal reason has been the relatively large rise in private capital outflows—an element of the balance of payments which might have been expected to advance less rapidly or even to decline in a period of rising domestic activity. While changes in the capital account are interrelated with other components in the balance of payments—for example, some capital outflows serve directly to finance our exports—and therefore should not be viewed in isolation, the over-all magnitude of capital outflows by mid-1963 had become clear cause for concern. This led to the adoption of special remedial measures, notably the imposition of the Interest Equalization Tax on purchases of new and outstanding foreign securities by U.S. investors.

In 1964, with foreign demand strong, the combination of influences and measures referred to above produced a continued reduction in the U.S. deficit on regular transactions. Further, this smaller deficit was financed to an unusually large extent by increases in private rather than official holdings of short-term balances, and outflows of gold were the smallest since 1957. Moreover, the strength of the multilateral currency arrangements worked out in recent years was dramatically demonstrated late in 1964 when, following a massive speculative attack against sterling, a $3 billion credit was extended to the United Kingdom by an 11-nation group and the Bank for International Settlements, with the United States taking a prominent part.

The progress achieved during 1964 further strengthened confidence in the dollar. Yet there are clouds in the record for the year that cannot be ignored and that raise new questions for the future. In particular, U.S. purchases of newly issued foreign securities as well as long-term bank loans to foreigners were unusually large in the latter part of the year, operating to produce a higher deficit in the fourth quarter.

The remainder of this chapter will deal with a number of key elements in the changing international position of the United States during the past four years: the gains in U.S. exports and in our competitive position; the reduction of net outflows on Government account; the shifting pattern of private capital flows; the development of new methods of financing our deficits and the progress in international financial cooperation. . . .

Objectives of International Economic Policies

The 1966 Report listed clearly the objectives of international economic policies, including the balance of payments problem (pp. 13–14).

INTERNATIONAL ECONOMIC POLICIES FOR 1966

These are the objectives of our international economic policies in 1966:
—to correct our remaining balance of payments deficit so that the dollar will remain strong;

—to work toward reduction of trade barriers, so that all nations may reap the benefits of freer trade;

—to improve the international monetary system, so that it will continue to facilitate sound and orderly growth of the world economy;

—to press forward with the other fortunate nations in the great international task of our age: helping those countries now economically less advanced which are prepared to help themselves make rapid progress toward a better life in freedom.

Balance of Payments

Decisive progress was made in 1965 toward reducing our balance of payments deficit. Though the results for 1965 are gratifying, we cannot afford to relax. We have not yet balanced our external accounts.

For 1966, external balance is our goal. It requires that

- Business continue to cooperate wholeheartedly in following the strengthened guidelines governing capital flows announced in December;
- Banks and financial institutions maintain their excellent performance of last year;
- Businesses sell even more abroad this year, in spite of full domestic order books;
- Business and labor keep costs and prices stable in order to maintain the competiveness of our goods and services in international markets;
- Government work vigorously to minimize the dollar drain abroad of its aid and defense programs as well as all other activities;
- The Congress pass the tax legislation I recommended last year to enhance opportunities for foreigners to invest in the United States;
- We intensify our efforts to encourage our own citizens and foreigners to travel in the United States. I am directing that high priority be given to these efforts.

Trade

The year 1966 is the year when the world can take a giant step forward in liberalizing international trade by successfully concluding the Kennedy Round of negotiations to reduce trade barriers on all classes of products. The resulting growth of world trade and world income will benefit all countries, developing as well as industrial. The United States will bend every effort to get meaningful negotiations back on the track. This great venture in international cooperation must not fail.

We shall continue our efforts to improve the trade prospects of the developing countries by helping to stabilize commodity trade, by supporting regional integration among them where practical, by providing access to markets, and by giving positive assistance to export promotion.

INTERNATIONAL MONETARY REFORM

As we achieve and maintain balance in our external accounts, dollars will no longer add to international monetary reserves as they have in the past. We learned long ago that we cannot rely on gold alone. The free world must look to new sources of liquidity—rather than to deficits in the U.S. balance of payments—to support growing international trade and payments.

We are, therefore, pressing forward with other nations

—to assure the adequate and orderly growth of world monetary reserves;

—to improve the adjustment of imbalances by both surplus and deficit countries;

—to strengthen the monetary system that has served the world so well.

Views of President Johnson, Economic Report of 1967

The 1967 Report by President Johnson continued the approach of the two preceding years, aimed at alleviating and correcting the balance of payments problem, as seen in the following extract (pp. 14–16):

BALANCE OF PAYMENTS

We can take some satisfaction in the fact that our balance of payments in 1966 may prove to have been in surplus on official reserve settlements. Despite the added costs of the war in Vietnam and the rapid growth of imports, our deficit on a liquidity basis increased only slightly in 1966.

But we cannot relax our efforts to seek further improvement.

Our goal in the coming year is to continue to move toward balance of payments equilibrium as rapidly as the foreign exchange costs of the Vietnam conflict may permit. This goal will be supported through measures and policies consistent with healthy growth at home and our responsibilities abroad.

We already have extended and reinforced the voluntary restraint programs for corporate investment abroad and for foreign lending by financial institutions. I am counting on the continued full cooperation of businesses and banks with these programs in 1967. And I have instructed all agencies of the Government to intensify their efforts to limit the dollar drain resulting from their activities.

But more is needed. I now recommend the following steps:

1. The Congress should extend the Interest Equalization Tax, in strengthened form, to July 31, 1969. This tax has proved extremely useful in limiting the borrowing of developed countries in our capital markets and in reinforcing the Federal Reserve vol-

untary program. As we move toward easier money in the United States, foreign borrowing in our financial markets may tend to increase. I am therefore requesting authority to adjust the rates of the Interest Equalization Tax as monetary conditions warrant, so that the effective impact on interest costs can be varied between zero and 2 percent. This would replace the present flat 1-percent impact.

Moreover, to ensure against possible anticipatory increases in foreign borrowing, I am also requesting that the tax be imposed at rates which provide an impact of 2 percent on interest costs while the legislation is under consideration by Congress.

2. The most satisfactory way to arrest the increasing gap between American travel abroad and foreign travel here is not to limit the former but to stimulate and encourage the latter. I shall appoint in the near future a special industry-Government task force to make specific recommendations by May 1, 1967, on how the Federal Government can best stimulate foreign travel to the United States. After a careful review of their advice, I shall ask the U.S. Travel Service and other appropriate agencies to take the steps that seem most promising.
3. As part of our long-run balance of payments program, I shall also
   —request continuation and expansion by $4.5 billion of the lending authority of the Export-Import Bank in order to support the expansion of exports;
   —continue to urge other countries to participate in the development of better means both of sharing the resource burdens and of neutralizing the balance of payments effect arising from the common defense and foreign assistance efforts.
4. For the longer run strength of our payments balance, we should intensify efforts to
   —stimulate exporters' interest in supplying foreign markets;
   —enlist the support of the financial community to attract additional foreign investment in the United States;
   —encourage further development of foreign capital markets.

In 1966, significant progress was made toward a better international monetary system. Through close consultation and cooperation among the financial authorities of major countries, temporary strains were met promptly and effectively.

Two large forward steps were taken on the road to international monetary reform: wide consensus was reached on basic principles for the deliberate creation of additional reserve assets; and the negotiations advanced to a second stage in which all members of the International Monetary Fund are participating.

An even greater effort must be made in the coming year to improve our monetary system. In particular, I urge that

—all countries participate in the continuing task of strengthening the basic monetary arrangements that have served the world so well;

—both surplus and deficit countries assume their full responsibility for proper adjustment of international payments imbalances, and cooperate in efforts to lower world interest rates;

—full agreement be reached on a constructive contingency plan for the adequate and orderly growth of world monetary reserves. . . .

12. MISCELLANEOUS ECONOMIC PROBLEMS AND POLICIES

In the Introduction we indicated that the President's Economic Reports basically are macro-economic in scope and content. This should not be taken, however, to mean that micro-economic issues relating to firm and consumer decisions are ignored. Indeed, there are virtually no topics within the range of economic principles, problems, and policies that are not treated in these reports.

In the foregoing sections, we have attempted to review how major economic policies are handled. Space has prevented a complete coverage, however, of all problem areas. There are a few remaining ones that we lump together in the following section, and present a sample of the manner in which they were handled in various reports. Others, such as consumer welfare, antitrust, urban development, and social security, we have mentioned as continuing policy areas, but editorial limitations preclude a fuller treatment of them.

(1) Unemployment

The 1962 Report presented an excellent description of the nature of and the problems associated with unemployment, as excerpted below (pp. 40–44):

> *Reasons for Concern over Unemployment*
>
> The great depression led this Nation, and most other nations of the free world, to assume national responsibility for the human tragedy and economic waste of involuntary unemployment. Unemployment had previously been regarded as almost solely the personal responsibility of the individual; now it came to be acknowledged as a charge on the conscience of the Nation. The mass unemployment of the 1930's led to a new understanding: that to be unemployed is not to be unemployable; that job opportunities for individual workers depend on national economic circumstances beyond their control.
>
> There are three principal reasons why involuntary unemployment is a national concern: (1) the human obligation to prevent and to relieve economic distress, (2) the basic principle of a free economy that an indi-

vidual should be able to choose freely how to use his time, whether to work for pay or not, and (3) the economic waste of leaving productive resources idle.

Preventing economic distress. First, a wealthy nation cannot in good conscience permit its citizens to be inadequately nourished, clothed, or housed; its sick to be denied medical care; or its young to be deprived of schooling. Unemployment insurance and public assistance are recognitions of this social obligation. But they are not substitutes for the opportunity to earn income from useful employment. For the breadwinner and his family, unemployment means a reduction in living standards. Only about three-fifths of the unemployed in 1961 were receiving unemployment insurance benefits. Even those who were insured generally found weekly benefits a pale shadow of their lost wages. When the unemployment insurance program was inaugurated in the late 1930's, the goal was to provide benefits equal to about half of previous earnings. As Table 1 indicates, benefits now do not meet this standard. The Administration has proposed permanent legislation to strengthen the unemployment insurance system in this and other respects.

For all too many, unemployment has not been simply an uncomfortable interlude between jobs but a catastrophe of long duration; almost one-third of those unemployed in December 1961 had been out of work for 15 or more weeks and one-sixth had been unemployed for at least 27 weeks. Family savings vanish when unemployment is prolonged.

Unemployment is not a perfect measure of the incidence of economic distress. Failure to find work does not entail poverty for some unemployed persons: women whose husbands have good jobs, young people who can fall back on well-to-do parents, older people who have assured livelihoods from property incomes or annuities, people who earn an adequate annual income from work at a seasonal occupation during part of a year. On the other hand, there are many causes of economic distress other than unemployment. Some persons, though employed, suffer from reduced and inadequate incomes resulting from failure to obtain more than part-time or occasional work, or to earn decent returns from long hours of self-employment on the farm or in the shop. Other individuals are not regarded as unemployed simply because, discouraged by a lack of suitable opportunities, they have abandoned the search for jobs. Included in this group are individuals with personal disabilities who can find jobs only when labor markets are tight.

Nevertheless, changes in unemployment are indicative of changes in the over-all magnitude of economic distress. The same conditions of general prosperity which lead to lower unemployment figures also lead to lower rates of involuntary part-time idleness, to better rewards from self-employment, and to more job opportunities for persons on the fringes of the labor force. While effective measures to provide adequate job opportunities will not solve all problems of economic distress, they will solve a substantial share of them. And without successful policy against general

the self-employed and new entrants to the labor force. (2) The unemployment rate among *married men living with their wives.* This measure relates to individuls whose commitment to the labor force is permanent and necessary to the support of their families. It does not cover all individuals with such a commitment. and conceptually it is inappropriate both as a measure of economic waste and as an indicator of involuntary unemployment among persons "able, willing. and seeking to work." (3) A *full-time equivalent* measure which (a) adds to the wholly unemployed the full-time equivalent of work lost by involuntary part-time employment and (b) subtracts the self-employed from both the labor force and civilian employment on the grounds that they are not subject to the risk of unemployment. This concept has merit as a measure of economic waste and of imbalance in markets for hired labor. (4) The number of *long-term unemployed,* those who have been jobless for more than 15 weeks, as a percentage of the labor force. This rate is an important measure of the financial and social distress caused by the concentration of prolonged unemployment on a small fraction of the labor force.

The differences among these measures reveal more clearly than any single measure the anatomy of unemployment. But they show no systematic tendency to widen or narrow. If due allowance is made for volatility in month-to-month movements all five measures tell the same story about changes in economic conditions. . . .

(2) Full Employment Surplus

The importance of the Federal budget is magnified as it acts as a drag against or stimulus to the economy. One way of studying the effects of the budget is by means of the concept of the full employment surplus. This concept was described and analyzed in the 1962 Council's Report (pp. 78–81).

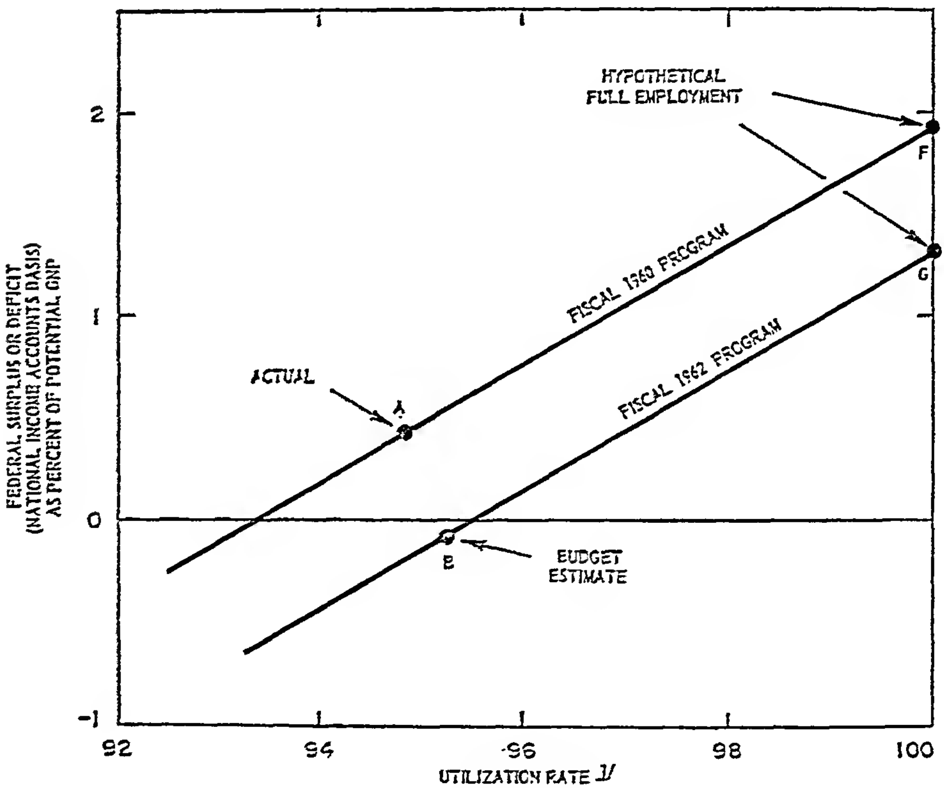
. . . [T]he magnitude of the surplus or deficit in the budget depends both on the budget program and on the state of the economy. The budget program fixes both tax rates and expenditure programs. The revenues actually yielded by most taxes, and the actual expenditures under certain programs like unemployment compensation, vary automatically with economic activity. To interpret the economic significance of a given budget it is, therefore. essential to distinguish the *automatic* changes in revenues and expenditures from the *discretionary* changes which occur when the Government varies tax rates or changes expenditure programs. The discussion that follows runs in terms of the national income accounts budget.

In Chart 6 this twofold aspect of fiscal policy is portrayed for the fiscal years 1960 and 1962. Since tax revenues and some expenditures depend on the level of economic activity, there is a whole range of possible sur-

pluses and deficits associated with a given budget program. The particular surplus or deficit in fact realized will depend on the level of economic activity. On the horizontal scale, Chart 6 shows the ratio of actual GNP to the economy's potential, labeled the "utilization rate." On the vertical scale, the chart shows the Federal budget surplus or deficit as a percentage of potential GNP.

CHART 6

Effect of Level of Economic Activity on Federal Surplus or Deficit



1/ACTUAL GNP AS PERCENT OF POTENTIAL GNP.
SOURCE: COUNCIL OF ECONOMIC ADVISERS.

The line labeled "fiscal 1960 program" represents a calculation of the budget surplus or deficit which would have occurred at various levels of economic activity, given the Federal expenditure programs and the tax rates of that year. For the reasons explained earlier, the same budget program may yield a high surplus at full employment and a low surplus or a deficit at low levels of economic activity. The actual budget position in fiscal year 1960, a surplus of $2.2 billion or 0.4 percent of potential GNP, is shown at point A; this accompanied a level of GNP 5 percent below potential. Had full employment been achieved that year, however,

the same basic budget program would have yielded a surplus of about $10 billion, or nearly 2 percent of gross national product (point F in the chart). The line labeled "1962 program" similarly shows the relationship between economic activity and the surplus or deficit, for the budget program of 1962; the expected deficit is shown at point B, and the full employment surplus at point G.

It is the height of the line in Chart 6 which reflects the basic budget program; the actual surplus or deficit depends both on the height of the program line and the level of economic activity. In other words, discretionary fiscal policy, by changing the level of Government expenditures or tax rates shifts the whole program line up or down. The automatic stabilizing effects of a given budget program are reflected in the chart by movements along a given line, accompanying changes in economic activity. One convenient method of comparing alternative budget programs, which separates automatic from discretionary changes in surplus and deficits, is to calculate the surplus or deficit of each alternative program at a fixed level of economic activity. As a convention, this calculation is made on the assumption of full employment. In Chart 6, the points F and G mark the full employment surplus in the budget programs of fiscal years 1960 and 1962, respectively. The statement, "the fiscal 1960 budget had a larger full employment surplus, as a fraction of potential GNP, than the 1962 budget" is a convenient shorthand summary of the fact that the 1962 budget line was below the 1960 line, yielding smaller surpluses or larger deficits at any comparable level of activity.

The full employment surplus rises through time if tax rates and expenditure programs remain unchanged. Because potential GNP grows, the volume of tax revenues yielded by a fully employed economy rises, when tax rates remain unchanged. Full employment revenues under existing tax laws are growing by about $6 billion a year. With unchanged discretionary expenditures, a budget line drawn on Chart 6 would shift upward each year by about 1 percent of potential GNP.

The full employment surplus is a measure of the restrictive or expansionary impact of a budget program on over-all demand. Generally speaking, one budget program is more expansionary than another if it has a smaller full employment surplus. One budget program might have the smaller full employment surplus because it embodies greater Federal purchases of goods and services, in relation to potential GNP. By the same token, it leaves a smaller share of full employment output for private purchase. This means that full employment is easier to maintain under the budget program with the smaller surplus, because less private demand is required. It also means that inflation is more difficult to avoid, because there are fewer goods and services to meet private demand should it prove strong. Alternatively, one budget program might have a smaller full employment surplus than a second because it involves either lower tax rates or larger transfer payment programs. In that event, private after-tax incomes are larger at full employment for the first budget program than

for the second. As a result, private demand would be stronger under the first program.

If the full employment surplus is too large, relative to the strength of private demand, economic activity falls short of potential. Correspondingly, the budget surplus actually realized falls short of the full employment surplus; indeed, a deficit may occur. If the full employment surplus is too small, total demand exceeds the capacity of economy and causes inflation.

But whether a given full employment surplus is too large or too small depends on other government policies, as well as on economic circumstances affecting the general strength of private demand. If the full employment surplus is too large, more expansionary monetary and credit policies may strengthen private demand sufficiently to permit full employment to be realized. Changes in tax structure, stimulating demand while leaving the yield of the tax system unchanged, might have the same effect. Similarly, restrictive changes in other government policies can offset the expansionary influence of a low full employment surplus. . . .

(3) National Income Accounts Budget

Most people are accustomed to think of the national budget as the Federal administrative budget. The national budget appears in several other forms, however. In its 1962 Report, the Council discussed the various forms the Federal budget may take. One of these forms, the national income accounts budget, is discussed (pp. 77–78) and compared with the other approaches as follows:

The effects of Federal receipts and expenditures on the income stream are most accurately represented when the budget is viewed in the framework of the national income accounts. These accounts present a consistent record and classification of the major flows of output and income for the entire economy, including the transactions of the Federal Government. There are three major differences between the Federal budget as it is conventionally presented (the so-called "administrative budget") and the accounts of the Federal sector as they appear in the national income. The major differences between these two budgets, and between both of them and the consolidated cash budget, are schematically summarized in Table 7. There are other, less significant differences among the budgets, such as the treatment of intragovernmental transactions.

First, the national income accounts budget, like the consolidated cash budget, includes the transactions of the trust funds, which amount currently to about $25 billion per year and have a significant impact on the economy. Highway grants-in-aid, unemployment compensation payments, and social security benefits are examples of trust fund transactions. Be-

TABLE 7.—*Major differences among three concepts of the Federal budget*

Item	Budget concept		
	Administrative	Consolidated cash	National income accounts
Timing of receipts	Collections	Collections	Accruals
Treatment of net loans and other credit transactions	Included	Included	Excluded
Treatment of trust fund transactions	Excluded	Included	Included

Source: Council of Economic Advisers.

cause the traditional budget—or administrative budget—is primarily an instrument of management and control of those Federal activities which operate through regular congressional appropriations, it excludes the trust funds, which have their own legal sources of revenue.

Second, transactions between government and business are, so far as possible, recorded in the national income accounts budget when liabilities are incurred rather than when cash changes hands. This adjustment in timing affects both government purchases and taxes, shifting them to the point in time at which they are likely to have their principal impact on private spending decisions. The choice of an accrual, rather than a cash, basis for timing is particularly important for the highly volatile corporate income tax. Since these taxes are normally paid more than six months after the liabilities are incurred, payments of corporate income taxes, as recorded in the administrative budget, run substantially below accruals in a period of rising economic activity. For fiscal year 1962, this difference is estimated at about $3 billion.

Finally, unlike the administrative budget, the national income accounts budget omits government transactions in financial assets and already existing assets. The largest omission is the volume of loans extended by the Federal Government. This volume is estimated at $4 billion net of repayments in fiscal year 1962. While these loans have important effects on economic activity, they are properly viewed as an aspect, not of fiscal policy, but of monetary and credit policy, and are so discussed later in this chapter. Borrowers from the Federal Government, like borrowers from private financial institutions, acquire cash by incurring debts. They add thereby to their liquidity, but not directly to their incomes. . . .

The idea of national income accounts budgeting received renewed attention by the Council of Economic Advisers in their 1967 Report (pp. 69–71). President Johnson later made great use of this approach along with the idea of the cash budget in his subsequent 1967 budget message.

The Federal Budget, National Income Accounts Basis

Throughout this Annual Report, Federal receipts and expenditures and budget surpluses or deficits are referred to in terms of the national income accounts (NIA) budget. This is a set of accounts devised by the Department of Commerce, as part of the national income statistics, to register the way that Federal fiscal transactions affect the income stream.

The principles followed in the NIA budget are relatively simple. In the first place, this budget is comprehensive and records all Federal transactions that directly alter private spendable income including that of State and local governments. It incorporates the fiscal transactions of all Federal agencies, regardless of the legal arrangements applying to these agencies. Thus, the accounts include operations of trust funds and other Government-owned agencies as well as regular Government departments.

Second, Federal transactions are counted at the time that they add to or subtract from private spendable income, which often is different from the time when funds are actually withdrawn from or deposited into Treasury accounts.

Third, all transactions involving loans or exchanges in assets are excluded. The Government engages in numerous lending and swapping transactions involving billions of dollars a year. These are extremely important to the operation of the economy, but they are not to be regarded as fiscal transactions because they do not affect disposable incomes directly.

In following these principles, the NIA budget differs in several important respects from the more familiar administrative budget. The administrative budget is the traditional vehicle for the management and control of most of the Federal programs which operate through regular Congressional appropriations. But it does not, and was not designed to, reflect even approximately the economic impact of fiscal policy.

Table 5.—*Relation of two measures of Federal budget surplus or deficit, calendar year 1966*

Description	Billions of dollars
Surplus or deficit (−), national income accounts budget	0.2
Plus: Seigniorage	.9
Excess of taxes received over taxes accrued	1.4
Miscellaneous adjustments (net)	1.0
Less: Excess of cash payments over goods received	1.0
Net loans and financial transactions	6.6
Surplus, Federal trust funds	2.2
Equals: Surplus or deficit (−), administrative budget	−7.3

Source: Bureau of the Budget and Department of Commerce.

For the calendar year 1966, the NIA budget was essentially balanced with a tiny surplus of $0.2 billion. But, in the administrative budget, expenditures outran receipts by $7.3 billion. The main elements account-

ing for this very large difference are shown in Table 5. Particularly important were Federal net loans and the net surplus of trust funds.

Trust funds. The administrative budget generally excludes both the revenues and expenditures of Federal trust funds. These funds include the various Social Security, hospital insurance, and Medicare funds, unemployment insurance, railroad and civil service retirement funds, the highway trust fund, veterans life insurance, and many others. Most transactions of trust funds directly affect the private income stream. Both expenditures and receipts are very large, approximately $40 billion. Moreover, the funds can be in substantial surplus or deficit in any year. In calendar 1966, they showed a net surplus of $3.2 billion. That surplus is properly reflected in the NIA budget, although ignored in the administrative budget. A third measure of Government financial transactions—the consolidated cash budget—corresponds in this respect with the NIA budget.

Timing. In business accounting, which provides the framework for decision-making by firms, purchases and sales of goods and services are typically recorded when liabilities are incurred rather than when cash changes hands. The NIA budget generally follows the same procedure. On the revenue side, withholding of personal income taxes is counted as a collection when the taxes are actually taken from the paychecks of employees rather than when employers pay the Government; excise and sales taxes are counted when the sales of taxable goods are actually made; and corporate income taxes are counted when they accrue. Similarly, on the expenditure side, Government purchases of goods from businesses are recorded at the time of delivery rather than at time of payment. In this respect, both the administrative budget and the consolidated cash budget differ from standard business accounting treatment by adopting a cash basis for the timing of transactions.

In 1966, cash collections of taxes exceeded accruals by about $1.4 billion, while cash disbursements for goods and services exceeded deliveries by $1.0 billion.

Seigniorage. The NIA budget and the administrative budget also differ in their treatment of Treasury profits on coinage operations (seigniorage), which amounted to $0.9 billion last year. When the face value of new coins minted exceeds the cost of metal used to produce them, the profit is counted as a receipt in the administrative budget. But it is not a Government receipt in the NIA budget, because the increase in Treasury cash balances which results is a purely internal Government bookkeeping entry which does not reduce or drain off private purchasing power.

Lending. A further and vital difference between the NIA budget, on the one hand, and the consolidated cash and administrative budgets, on the other, involves the treatment of lending, loan repayment, and sales of financial assets. Such financial transactions are excluded from the NIA budget because they do not change the net worth or incomes of private parties, but only their liquidity. The reasoning follows the same

line applied above to tax accruals and profits on coinage. Just as businesses do not regard themselves as becoming poorer at the time they actually pay taxes they already owe, neither do they consider repaying a Government loan as a current expense. Nor conversely, do their incomes rise when they obtain loans from the Federal Government. Yet, in the administrative budget a new Federal loan increases the deficit as much as an outlay that directly raises private income, and sale or repayment of the loan diminishes it just as much as a tax payment.

To be sure, many Federal loan transactions have important effects on private spending. But they work in a less direct way than the income-generating transactions. They channel funds at low costs to various activities deemed to be of particular social or economic importance, such as exports, college, housing, and farm production. Given the level of tax revenues, when the Government lends more, it must also borrow more. The net impact of a Federal loan financed by Government borrowing is that Government liabilities—Treasury and agency issues—are substituted for private debts.

Such substitution is likely to improve the terms and lower the interest rates available to some borrowers. But other borrowers may be displaced, depending on credit conditions and monetary policy. Federal lending is best regarded as an aspect of monetary, credit, and debt management policy—not of fiscal policy. When it lends borrowed funds, the Government is acting as a financial institution, much like private financial institutions. Borrowers from private financial institutions also increase their liquidity. They acquire cash by incurring debts. They are, indeed, better off for the opportunities to borrow, and they may spend more as a result; but they do not regard the borrowing as an addition to their incomes.

In the past year, the Federal Government was a net lender, partly because of the scarcity of funds in private financial markets. The difference between the two budgets on this account amounted to $6.6 billion.

(4) Automation

The challenge of automation was analyzed by the Council in an appendix to the 1964 Report. Highlights from this presentation are given below (pp. 184–187).

The Challenge of Automation

In a way it is surprising how reluctant we are to embrace the higher productivity levels and living standards which "automation" makes possible. Some of the more popular literature on the subject treats it as a new and frightening development. But in fact, it is only the most recent aspect of a continuing process of technological advance that dates back to the beginning of the Industrial Revolution. Taking full advantage of this process, the United States has built the most productive and most remunerative economy in the world. Through time, brute strength has been

progressively replaced by simple machines, mechanical power, complex machines, assembly lines, and today increasingly by sophisticated automatic feedback systems. At each stage of the process individuals were temporarily displaced from existing jobs, new skills were found to be needed and were acquired, and total output and employment expanded as demand increased in line with the new higher production capabilities.

Ultimately the total effect has always in the past been a higher standard of living for almost everyone—higher pay for workers, cheaper and better products for consumers, and larger profits for businessmen and stockholders. On the basis of our historical experience, automation should be recognized for what it is—an open door to a more productive economy, to higher levels of private consumption, to more effective public services, and to larger resources for the support of our international objectives.

Despite this historical record, it is occasionally argued that the newest techniques are becoming so much more productive than those they replace that we cannot possibly adjust to them as smoothly as in the past. As indicated earlier, the evidence available to date does not enable us to draw firm conclusions about the prospective rate of increase in productivity. Yet, it is clearly *possible* that as the newest production techniques are increasingly embodied in new capital, the future growth of productivity will speed up.

Should this possibility be a source of concern? Rather than viewing it with concern or alarm, we would argue that we should work as hard as we can for faster productivity growth—indeed, it holds the key to success of our national policies for faster economic growth and for the cost-cutting that is essential to our international competitive position. It is a prime objective of this year's tax bill as well as last year's special tax stimulants to investment.

Doubts about our ability to adjust to automation seem to be based on two questions: Can we really use the enlarged output of goods and services made possible by a rising rate of productivity advance? Will the new speed and character of technological change create impossible problems of adjustment for the labor force?

Those who raise the first question sometimes argue that we cannot possibly consume all that the new techniques can produce—that the persistent high level of unemployment over the past few years is evidence of "satiation"—that the fantastic productivity of the American economy has outdistanced the needs of the American people. What do the facts show?

First and most obvious, it is impossible to square this notion with the persistence of poverty in the American economy. We are indeed an affluent society, by every comparative standard. Nonetheless, even in this age of affluence, one-fifth of American families still have annual incomes below $3,000—that is, they live in poverty. To them, the suggestion that we are economically satiated must seem ridiculous, if not cruel. Until our society has met the challenge of poverty in the midst of plenty, it is in no danger of being satiated with goods and services.

But—quite apart from the persistence of poverty—there is nothing in the economic behavior of even the more affluent American consumers to support the satiation hypothesis. At all income levels—except perhaps in the top 2 or 3 percent of the income-wealth distribution—the ratio of consumption to disposable income is one of our most stable economic relationships. Year-in, year-out—ever since 1950—American consumers have continued to spend from 92 to 94 percent of their aggregate disposable income—their income after taxes—on consumer goods and services. During this period total income and average family income have both risen markedly; but there is no evidence of any growing disinclination to spend a stable and high percentage of each additional dollar of income on consumption. Even those in the upper "middle" income groups, who are already able to meet without strain the basic requirements for food, clothing, housing, and transportation find that they have ample, and often urgent uses, for additional incomes. This may take the form of an improved quality or manner in which basic requirements are satisfied—a larger house, a newer car—or it may take the form of meeting new and different demands: longer and more rewarding vacations, better education for one's children, better medical care, more books and more concerts, and more expensive hobbies.

This does not, of course, rule out the possibility that—as in the past—some, many, or even all of us will prefer to forego still higher income in favor of greater leisure in the form of shorter hours, longer vacations, or earlier retirements. (There are indications, incidentally, that many people find it easier to become satiated with leisure than with income!)

In addition to unsatisfied private consumption needs, there are pressing needs for goods and services which are ordinarily and in some cases inevitably provided by the public sector. Admittedly there is disagreement as to just which of these "public goods" most need to be increased. There are also differences of opinion as to which levels of government should undertake expanded activities. Nevertheless, almost all major segments of the American community support increases in the level of one or another of such "public" goods and services, whether they be, for example, urban renewal, or improved health services, or better schools, or better roads and airports, or purer water and air, or more adequate facilities in national parks. Certainly none of this bespeaks a satiated society.

In a somewhat different vein, it should also be noted that technologically advancing societies also generate high levels of investment demand, demand for producer goods like machines, equipment, buildings. In large part, of course, this reflects the favorable impact of new technological developments on the profitability of investment. During most of our history, American business has responded to such opportunities by enlarging its investment outlays. Postwar Western Europe and Japan provide examples of economies with impressive rates of productivity increase along with buoyant demand, reflecting—more than anything else—extremely high quotas of investment.

Clearly, we need not fear that the increasing productivity associated with even a speeded-up rate of technological progress will founder upon a contradiction between our needs and our ability to satisfy them. As people continue to receive the extra incomes which our enlarging production can generate, they will also continue to use those extra incomes to buy the enlarged output—for private and public consumption and for investment.

The second question raised about our ability to adjust to automation concerns the labor force adjustments it necessitates.

If the advance of technological progress has speeded up, it is reasonable to suppose that, as a by-product, the rate at which particular skills are rendered obsolescent is also increasing. But a further and different point is sometimes made, namely, that automation (in its narrower technical sense) is shifting not merely the *rate* but the *character* of skill requirements generated by technological change. Previously, it is suggested, technological change simplified the work process and hence created many semi-skilled jobs, which could be filled by workers with little training. Automation, however, reintegrates the production process and thus eliminates many unskilled and semi-skilled jobs.

Whether this interpretation is correct is a highly complex empirical question. Many of the jobs displaced by automation are low-skilled and some of the jobs added are extremely high-skilled. The design and installation of automation equipment surely requires highly trained personnel. Yet the need for these people is clearly limited, and they do not stay with the equipment long after installation. Once in operation, the equipment may actually diminish rather than raise skill requirements. Examples of highly automated installations have been cited where all of the maintenance is done by high school graduates with a fairly short trade school course in electronic repair. High skills are required for the programming function, but this also tends to be concentrated in the initial stages and "canned" programs are increasingly available in some applications. A good deal more study and experience is needed before we can safely generalize about the impact of automation on skill requirements for the labor force as a whole.

Beyond the question of how automation (in the narrow sense) affects average skill requirements lies the broader question of the impact on labor markets of any general acceleration that may occur in the rate of technological advance. This broader question involves at least two dimensions.

A "vertical" dimension relates to the impact of speeded technological change on the long-term rate of increase in the average educational content of jobs. As noted repeatedly, our past rapid increase in educational levels has both responded to and helped bring about our steady technological advance and rising productivity. The exact nature of the complex interrelationships between the average educational accomplishment of the labor force, job educational requirements, and a further speeding up of the pace of technological advance is a matter for some

speculation. But whatever the answer, more and better education will continue to have one of the highest priorities among the values of American society.

The "horizontal" dimension of our question requires less speculation. We can be certain that a speeded pace of technological change will increase the rate of job displacement, and will require even greater attention to measures for improving labor mobility, for training and retraining of workers, and for an effective level of basic education to promote adaptability and flexibility. The possibility of an accelerated pace of technical change thus underscores an already powerful case for stronger labor market policies to meet existing problems of displacement.

Our past economic growth has brought unparalleled levels of well-being for all in our society. Today we need and we actively seek even higher levels of productivity, to help us solve both domestic and international problems. If, as a result of our policies to stimulate investment and improve efficiency, or as an unexpected bonus from autonomous developments in technology, the U.S. rate of productivity growth accelerates, we may encounter problems, but we will reap large rewards. If we pursue appropriate policies, we can meet the challenge of automation.

(5) Poverty

One of the newer topics, receiving detailed attention in the 1964 Presidential Report, was that of the "War on Poverty." Various policies for "waging" this war were suggested (pp. 14–15) as the beginning of the "Great Society."

The Council's Report devoted a full chapter to the problem of poverty, as highlighted below (pp. 55–57).

THE WAR ON POVERTY

In the State of the Union Message, I announced that this Administration was declaring unconditional war on poverty in America. I shall present the details of the attack, including legislative proposals, in a later special message to the Congress.

Americans today enjoy the highest standard of living in the history of mankind. But for nearly a fifth of our fellow citizens, this is a hollow achievement. They often live without hope, below minimum standards of decency.

The per capita money income of these 35 million men, women, and children was only $590 in 1962—against $1,900 per capita for the Nation as a whole.

We cannot and need not wait for the gradual growth of the economy to lift this forgotten fifth of our Nation above the poverty line.

We know what must be done, and this Nation of abundance can surely afford to do it.

The Role of Prosperity and Faster Growth

Today, as in the past, higher employment and speedier economic growth are the cornerstones of a concerted attack on poverty:

—In the Great Depression mass unemployment made poverty all too common an experience.

—Since 1947, prosperity and progress have reduced the incidence of substandard incomes from one-third to one-fifth of the Nation.

—But the erosion of poverty slowed measurably after 1957.

—The tax cut will once again generate jobs and income at a pace that will provide an escape from poverty for many of our least fortunate families.

But general prosperity and growth leave untouched many of the roots of human poverty. In the decade ahead, the forgotten fifth must be given new opportunities for a better life.

There are two major prongs to our specific attack on poverty in America:

First, to enable every individual to build his earning power to full capacity

Second, to assure all citizens of decent living standards regardless of economic reverses or the vicissitudes of human life and health. . . .

THE PROBLEM OF POVERTY IN AMERICA

In his message on the State of the Union, President Johnson declared all-out war on poverty in America. This chapter is designed to provide some understanding of the enemy and to outline the main features of a strategy of attack.

Eliminating Poverty—A National Goal

There will always be some Americans who are better off than others. But it need not follow that "the poor are always with us." In the United States today we can see on the horizon a society of abundance, free of much of the misery and degradation that have been the age-old fate of man. Steadily rising productivity, together with an improving network of private and social insurance and assistance, has been eroding mass poverty in America. But the process is far too slow. It is high time to redouble and to concentrate our efforts to eliminate poverty.

Poverty is costly not only to the poor but to the whole society. Its ugly by-products include ignorance, disease, delinquency, crime, irresponsibility, immorality, indifference. None of these social evils and hazards will, of course, wholly disappear with the elimination of poverty. But their severity will be markedly reduced. Poverty is no purely private or local concern. It is a social and national problem.

But the overriding objective is to improve the quality of life of individual human beings. For poverty deprives the individual not only of

material comforts but of human dignity and fulfillment. Poverty is rarely a builder of character.

The poor inhabit a world scarcely recognizable, and rarely recognized, by the majority of their fellow Americans. It is a world apart, whose inhabitants are isolated from the mainstream of American life and alienated from its values. It is a world where Americans are literally concerned with day-to-day survival—a roof over their heads, where the next meal is coming from. It is a world where a minor illness is a major tragedy, where pride and privacy must be sacrificed to get help, where honesty can become a luxury and ambition a myth. Worst of all, the poverty of the fathers is visited upon the children.

Equality of opportunity is the American dream, and universal education our noblest pledge to realize it. But, for the children of the poor, education is a handicap race; many are too ill prepared and ill motivated at home to learn at school. And many communities lengthen the handicap by providing the worst schooling for those who need the best.

Although poverty remains a bitter reality for too many Americans, its incidence has been steadily shrinking. The fruits of general economic growth have been widely shared; individuals and families have responded to incentives and opportunities for improvement; government and private programs have raised the educational attainments, housing standards, health, and productivity of the population; private and social insurance has increasingly protected families against loss of earnings due to death, disability, illness, old age, and unemployment. Future headway against poverty will likewise require attacks on many fronts: the active promotion of a full-employment, rapid-growth economy; a continuing assault on discrimination; and a wide range of other measures to strike at specific roots of low income. As in the past, progress will require the combined efforts of all levels of government and of private individuals and groups.

All Americans will benefit from this progress. Our Nation's most precious resource is its people. We pay twice for poverty: once in the production lost in wasted human potential, again in the resources diverted to coping with poverty's social by-products. Humanity compels our action, but it is sound economics as well.

This chapter considers, first, the changing numbers and composition of America's poor. Second, it presents a brief report on the factors that contribute to the continuation of poverty amidst plenty. Although the analysis is statistical, the major concern is with the human problems that the numbers reflect. The concluding part concerns strategy against poverty in the 1960's and beyond. Supplementary tables at the end of the chapter provide further data on the dimensions of poverty in America.

The sections below will chart the topography of poverty. A few significant features of this bleak landscape deserve emphasis in advance. Poverty occurs in many places and is endured by people in many sitautions; but

its occurrence is nonetheless highly concentrated among those with certain characteristics. The scars of discrimination, lack of education, and broken families show up clearly from almost any viewpoint. Here are some landmarks:

—One-fifth of our families and nearly one-fifth of our total population are poor.

—Of the poor, 22 percent are nonwhite; and nearly one-half of all non-whites live in poverty.

—The heads of over 60 percent of all poor families have only grade school educations.

—Even for those denied opportunity by discrimination, education significantly raises the chance to escape from poverty. Of all nonwhite families headed by a person with 8 years or less of schooling, 57 percent are poor. This percentage falls to 30 for high school graduates and to 18 percent for those with some college education.

—But education does not remove the effects of discrimination: when nonwhites are compared with whites at the same level of education, the nonwhites are poor about twice as often.

—One-third of all poor families are headed by a person over 65, and almost one-half of families headed by such a person are poor.

—Of the poor, 54 percent live in cities, 16 percent on farms, 30 percent as rural nonfarm residents.

—Over 40 percent of all farm families are poor. More than 80 percent of nonwhite farmers live in poverty.

—Less than half of the poor are in the South; yet a southerner's chance of being poor is roughly twice that of a person living in the rest of the country.

—One-quarter of poor families are headed by a woman; but nearly one-half of all families headed by a woman are poor.

—When a family and its head have several characteristics frequently associated with poverty, the chances of being poor are particularly high: a family headed by a young woman who is nonwhite and has less than an eighth grade education is poor in 94 out of 100 cases. Even if she is white, the chances are 85 out of 100 that she and her children will be poor.

(6) *Agriculture*

Although the problems of agriculture were considered in the prior Council Reports, in 1966 much more specific attention was given to this sector (pp. 131–136) as follows:

PROGRESS AND PROBLEMS IN AGRICULTURE

Agriculture is one of the most progressive segments of the American economy. Productivity has grown faster there than in any other major economic sector. U.S. agricultural abundance is the envy of the world.

Yet incomes of most farm families continue to fall short of those earned in other occupations. And agricultural employment is steadily declining. This paradox is a perennial source of confusion and protest.

For many years our commercial farms have had a total capacity to produce far in excess of the ability of our markets to absorb at reasonable prices. The causes of this are not hard to understand. As incomes have expanded, an ever smaller fraction of them has been used to buy the products of our farms. Over the past 50 years, disposable real income per capita in the American economy has nearly doubled; per capita consumption of farm products has risen by only 17 percent. As we become more affluent, we eat better and dress better. But most of our additional income goes for other goods and services that require little or no input from farms. Because the "income elasticity" of demand for farm products is low, the fraction of the labor force engaged in agriculture would be expected to decline as total incomes rise.

This relative decline in the need for farmers' services has been greatly intensified by another essential fact: the productivity of farm workers has been increasing much more rapidly than productivity in the economy generally. Because of the slow growth of demand and the rapid increase in productivity, there has been a persistent tendency for farm products to be overproduced, depressing farm prices. But the "price elasticity" of demand is likewise low: lower market prices do not result in greatly increased consumption of most farm products in the U.S. market.

Exactly 50 years ago, the American farm population reached its peak—32.5 million people—32 percent of the total population. One American farm worker produced sufficient food and fiber to supply himself and 7 other people. Today, farm people total less than 13 million and make up 6.4 percent of the population. Each farm worker produces enough food and fiber to meet the needs of more than 33 persons.

The steady and rapid decline in the demand for farm labor and the natural increase of the farm population have meant that agriculture is rapidly expelling a sizable fraction of its actual and potential workers. Since 1940, 25 million people—on the average, 1 million a year—have left the farm. Although the vast migration from farm to nonfarm occupations and from rural to urban areas proves that mobility is high, the outward movement has never been fast enough to improve significantly the economic position of farm labor relative to labor in the nonfarm economy. Despite programs designed to minimize the income gap, farm incomes historically have been depressed relative to incomes elsewhere.

Today, incomes of many farm families are low, particularly incomes of those who live on small inefficient farms and who have been unable to adapt to modern agricultural technology. However, a substantial number of farmers who have successfully adapted and who produce the bulk of our food and fiber are realizing incomes nearly equal to what their resources could earn off the farm.

For many low-income persons, a move to nonfarm occupations is not possible. Some farm residents are too old, do not have or cannot acquire the necessary skills, or simply lack the resources needed to finance a change. Consequently, the least mobile portion of the farm labor force remains stranded in eddies of rural unemployment or underemployment—on small farms, or in barely remunerative rural nonfarm occupations. Poverty is one of rural life's most urgent yet neglected problems. And some of those who do move to cities in hope for a better life often find themselves ill equipped for the jobs that are available and socially unable to adjust to the ways of urban life.

Farm people who are able to migrate successfully usually earn more than they could in farming. Those who remain are helped as well, since the transfer of labor out of agriculture reduces the excess resources which hold down average farm incomes.

These few basic considerations oversimplify the complex factors at work in U.S. agriculture and the difficult issues involved in framing agricultural policy. Some of these issues and complexities are discussed in the sections which follow: the changing importance of labor, land, and purchased inputs in farming; the potentially vast but uncertain world market for our farm products; the increasingly separate problems of commercial agriculture and of rural poverty; and the various public policy approaches for dealing with these problems.

COMMERCIAL AGRICULTURE IN THE 1960'S

Midway through the 1960's commercial agriculture is a highly efficient, competitive industry adjusting to market forces and a rapidly changing technology. Labor and, to a lesser extent, land are being replaced by such other inputs as fertilizers, insecticides, machinery, and equipment. Bigger and faster machines enable the individual farmer to operate on a larger scale. Thus commercial farms are becoming fewer in number and larger in size.

Between 1950 and 1965, farm output increased by 35 percent while the quantity of total inputs rose by only 3 percent. Output would have risen more if there had not been production control programs. The production gains were achieved with 11 percent less cropland and 45 percent fewer man-hours than in 1950. But the use of fertilizer more than doubled, and somewhat more mechanical power was employed. Today, 56 million acres of cropland are withheld from production through Government programs—about one-sixth of the crop acreage in the United States.

Productivity per acre has grown rapidly. Crop production per acre in 1965 was 18 percent greater than the 1959–61 average. Wheat yields rose by 12 percent, cotton 19 percent, and corn 29 percent. Increases in yields will continue as farmers adopt the new technology constantly being devised by university and Department of Agriculture scientists, agricultural chemical companies, and machinery manufacturers.

Structural Changes

The economic development of U.S. agriculture is producing two distinct sectors—one expanding and one contracting—within the farm economy.

The contracting sector, presently comprised of about 2 million farms with gross annual sales of less than $10,000, is characterized by a rapidly declining number of farms. It has been the source of much of the labor flow from agriculture. The decrease in the total number of farms between 1960 and 1965 is estimated at 573,000—with most of this decline resulting from a decrease in the number of full-time farms with annual sales of less than $5,000. Many of these small units disappeared through consolidation with other farms; some grew in size and entered agriculture's expanding sector. This trend of declining numbers of small farms is expected to continue.

The expanding sector, made up of farms with annual gross sales in excess of $10,000, is growing rapidly. Many of the farmers in this sector are realizing returns nearly comparable with what their resources could earn in nonfarm occupations. During 1960–65, the number of farms in this sector increased by one-fifth, to slightly more than 1 million, or 31 percent of all farms; the share of farm marketings provided by these farms rose from 73 percent of the total to an estimated 83 percent. Yet the farms in the expanding sector typically remain family enterprises: the percentage of family farms (farms with families as risk-taking managers and using less than 1.5 man-years of hired labor) has not changed since 1960.

Adjustments in agriculture's expanding sector have required greatly increased amounts of financial capital. Total farm indebtedness has increased more than 50 percent since 1960, largely in the form of higher farm real estate debt. Rapid farm consolidation has required additional real estate credit as well as shorter term credit for equipment and working capital. Active bidding for available farm land has helped to raise agricultural land values by 6 percent during the past year. The average value of real estate per farm now exceeds $50,000. Increased land values permitted farm proprietors' equities to grow to record levels in 1965. Although the increasing ratio of farm debt to total farm assets and incomes is evoking some concern, foreclosure rates remain very low.

Farm Income

Gross farm income, including marketing receipts, Government payments, and nonmoney income from farms, has risen steadily since 1960. Gross income in 1965 totaled $44.4 billion, an increase of more than 5 percent from 1964 and 17 percent from 1960. Total marketing receipts in 1965 rose sharply above those in 1964, largely as a result of higher prices for meat animals. Receipts from crops increased moderately, reflecting higher prices and larger marketings of vegetables and oil crops.

Direct Government payments to farmers are estimated to have been $250 million more than the $2.2 billion paid in 1964.

Realized net farm income (excluding net inventory change) in 1965 is estimated at $14.1 billion, nearly 9 percent above 1964 and the highest since 1952. On a per farm basis, operators' realized net income in 1965 reached a record $4,175, a 12 percent increase over 1964 and 41 percent higher than in 1960.

The 1966 prospect for commercial agriculture appears favorable, owing in large part to continued prosperity in the nonfarm sector. Rising levels of income at home and abroad will strengthen the demand for many farm products. The Food and Agriculture Act of 1965 will provide some income gains to farmers. Net farm income is expected to rise moderately. Much of this gain will accrue to the 1 million farms in agriculture's expanding sector.

POVERTY IN AGRICULTURE

Even in a prosperous economy, many rural people are unable to earn a satisfactory living in agriculture. Estimates based on the 1960 Population Census indicate that 4.9 million farm people in 1959 were living in poverty, as defined by the Social Security Administration's poverty-income standard. Many of these were families living on low-production farms, seriously undercapitalized in equipment and livestock. Today, nearly all families operating full-time farms with gross sales of less than $2,500 a year fall into this classification; many of those with annual sales of between $2,500 and $5,000 are also poor. Families on most of these farms derive relatively little benefit from Government price and income support programs.

Underemployment is the common malady of the farm poor. Their hope for a more adequate income lies in their ability to obtain work off the farm. For some, this requires migration to localities where nonfarm jobs are available. For many, it means *occupational migration*—remaining on the land but earning a livelihood from some occupation other than farming. But others, for health, age, or financial reasons, may find neither type of migration possible. These persons constitute the "hard core" of rural poverty. Their problems are the most intractable of all.

Both occupational and geographic migration have been occurring at a rapid pace in recent years. Net migration from farms during the early 1960's is estimated at 816,000 people annually. Preliminary data from the 1964 Census of Agriculture indicate that much of this movement occurred in the Mississippi Delta and other areas of the South.

Included in this migration have been large numbers of Negro farm families—a group with a particularly high incidence of poverty. Between 1960 and 1964, the numbers of nonwhites on farms decreased by 35 percent whereas the white farm population fell by 14 percent. Nonwhites account for one-third of the total decline in the farm population since 1960.

Although the number of farm people in poverty has declined substantially in recent years, this has resulted more from outmigration than from an improvement in the earnings of low-income farmers. Some of those who give up farming earn more adequate income in their new jobs and thus escape poverty. Those less fortunate in their search for other employment may drop out of farm poverty only to find themselves among the nonfarm poor.

Prosperous conditions in the nonfarm economy have aided many of the farm poor by facilitating their transfer to higher paying jobs outside of agriculture. Government programs emphasizing education and regional economic growth will also assist rural low-income people. The Manpower Development and Training programs are providing some persons with the skills necessary to compete effectively for nonfarm jobs. During the summer of 1965, 156,000 rural children participated in Project Head Start. The Economic Opportunity Act of 1964 provides health facilities, day camps, and special education programs for children of migrant workers. Education in rural areas will be improved through the Elementary and Secondary Education Act of 1965 which allocates Federal funds to school districts with heavy concentrations of children from low-income families. The Public Works and Economic Development Act of 1965 authorizes funds for regional economic development programs in low-income areas. The Department of Agriculture's new established Rural Community Development Service will facilitate the extension to rural areas of services provided by Government programs.

But the remaining tasks are great. In 1964, the incidence of poverty among farm households was 30 percent, compared with 19 percent for nonfarm families. Money income that year for poor farm households averaged $954; income for other farm households averaged $5,671.

Farm poverty exists in many rural areas of the United States but is particularly prevalent in the South and in Appalachia. Scattered but significant farm poverty persists in the Ozark region and some areas of the Southwest and Northwest. Migrant and other hired farm workers continue to be among the most disadvantaged people in America. National prosperity scarcely touches the lives of these individuals. . . .

PART FOUR

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Recommendations to Strengthen the Economy

Although all of the Economic Reports make numerous recommendations for Congressional action, some of the reports devoted a special section to proposed legislative recommendations.

Below we have summarized the major recommendations for action in recent reports. The type of economic behavior that followed is reviewed as well. One of the effects of the reports in this connection has been their influence on Congress also to take administrative action, short of legislation.

It is fitting to close this book with a look at some of these recommendations and note how they have affected legislative and administrative action as well as the direction of national economic policy.

The 1960 Report presented a somewhat comprehensive program for legislation. This included retention of certain taxes (motivated by ideas of the importance of budgetary balance): measures to strengthen the antitrust laws. to help small business. and to support agriculture, natural resources, and research and development; welfare measures, including aid to education and social security; and assistance to area redevelopment and housing.

In its Appendix B, the 1960 Report contained several important studies. These included an analysis of the growth of population. employment and earnings, agriculture. and foreign trade and payments.

The 1961 Report also had three special appendices. containing significant studies dealing with employment and earnings, agriculture, and foreign trade and payments.

The 1963 Report listed the following measures undertaken in 1961–62 to strengthen the economy:

The Trade Expansion Act of 1962
New Guidelines for Depreciation

The 1967 Report stressed the important role of the Federal government in providing assistance to the disadvantaged and numerous welfare measures were suggested. An important part of this Report also considered what might happen to the economy when the expenditures due to the Vietnam affair ceased. A complete note of optimism for the progress of the economy was expressed in this connection inasmuch as funds released from national defense efforts might then be devoted to various welfare programs.

1. THE EMPLOYMENT ACT OF 1946

WE CITE BELOW the text of the Employment Act of 1946, and call attention to the declaration of policy, the requirement for the Economic Report, the creation of the Council of Economic Advisers, and the establishment of the Joint Economic Committee.

[PUBLIC LAW 304—79TH CONGRESS]

AN ACT To declare a national policy on employment, production, and purchasing power, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SHORT TITLE

SECTION 1. This Act may be cited as the "Employment Act of 1946."

DECLARATION OF POLICY

SEC. 2. The Congress hereby declares that it is the continuing policy and responsibility of the Federal Government to use all practicable means consistent with its needs and obligations and other essential considerations of national policy, with the assistance and cooperation of industry, agriculture, labor, and State and local governments, to coordinate and utilize all its plans, functions, and resources for the purpose of creating and maintaining, in a manner calculated to foster and promote free competitive enterprise and the general welfare, conditions under which there will be afforded useful employment opportunities, including self-employment, for those able, willing, and seeking to work, and to promote maximum employment, production, and purchasing power. . . .

ECONOMIC REPORT OF THE PRESIDENT

SEC. 3. (a) The President shall transmit to the Congress not later than January 20 [1] of each year an economic report (hereinafter called the "Economic Report") setting forth (1) the levels of employment, production, and purchasing power obtaining in the United States and such levels needed to carry out the policy declared in section 2; (2) cur-

[1] In the original Act, before amendments, this read: "within sixty days after the beginning of each regular session (commencing with the year 1947)." This was changed to "at the beginning of each regular session" in the Legislative Reorganization Act of 1946, Public Law 601, 79th Congress, 1st session.

rent and foreseeable trends in the levels of employment, production, and purchasing power; (3) a review of the economic program of the Federal Government and a review of economic conditions affecting employment in the United States or any considerable portion thereof during the preceding year and of their effect upon employment, production, and purchasing power; and (4) a program for carrying out the policy declared in section 2, together with such recommendations for legislation as he may deem necessary or desirable.

(b) The President may transmit from time to time to the Congress reports supplementary to the Economic Report, each of which shall include such supplementary or revised recommendations as he may deem necessary or desirable to achieve the policy declared in section 2.

(c) The Economic Report, and all supplementary reports transmitted under subsection (b) of this section, shall, when transmitted to Congress, be referred to the joint committee created by section 5. . . .

COUNCIL OF ECONOMIC ADVISERS TO THE PRESIDENT

SEC. 4. (a) There is hereby created in the Executive Office of the President a Council of Economic Advisers (hereinafter called the "Council"). The Council shall be composed of three members who shall be appointed by the President, by and with the advice and consent of the Senate, and each of whom shall be a person who, as a result of his training, experience, and attainments is exceptionally qualified to analyze and interpret economic developments, to appraise programs and activities of the Government in the light of the policy declared in section 2, and to formulate and recommend national economic policy to promote employment, production, and purchasing power under free competitive enterprise. The President shall designate one of the members of the Council as Chairman.

(b) The Council is authorized to employ, and fix the compensation of, such specialists and other experts as may be necessary for the carrying out of its functions under this Act, without regard to the civil service laws and the Classification Act of 1949, as amended, and is authorized, subject to the civil service laws, to employ such other officers and employees as may be necessary for carrying out its functions under this Act, and fix their compensation in accordance with the Classification Act of 1949, as amended.

(c) It shall be the duty and function of the Council—

(1) to assist and advise the President in the preparation of the Economic Report;

(2) to gather timely and authoritative information concerning economic developments and economic trends, both current and prospective, to analyze and interpret such information in the light of the policy declared in section 2 for the purpose of determining whether such developments and trends are interfering, or are likely to interfere, with the achievement of such policy, and to compile

States are intensified by—if not always caused by—a rhythm in inventory investment, alternating between periods in which stocks are accumulating at an excessively high rate and periods in which they are being liquidated. But it is not beyond hope that stabilization measures, both automatic and discretionary, can be strengthened in force and improved in timing so as to compensate for inventory swings better than has been true in the past. If this is done the swings themselves will be dampened.

The possible gains from improved economic stabilization are impressive. Losses of production, employment, and consumption will be cut. More saving and investment will be realized, contributing steadily to the long-run growth of production potential. Business, consumer, and labor decisions will allocate resources more efficiently when they respond less to cyclical prospects and more to long-run developments. There will be less need and less justification for restrictive practices which are now designed to provide sheltered positions in markets periodically hit by recession.

It is true that an economy operating steadily at a high level of employment, with only limited excess plant capacity, is more subject to the risks of price increases than an economy with heavy unemployment and large unused capacity. However, the dampening of economic fluctuations may itself help to counter this tendency. Cyclical fluctuations have been exerting a "ratchet effect" on prices; costs and prices have been relatively inflexible downward in recessions but have been responsive to increases in demand during recoveries. Cyclical swings in total spending also tend to be accompanied by sharp and transitory shifts in the composition of spending. Because prices and costs respond more readily to upswings than to downswings, these rapid changes in the composition of demand impart an upward bias to the whole price level. These sources of upward price bias will tend to be reduced as a more even pace of advance is achieved.

To capitalize on the potential gains of stabilization requires skillful use of all economic policy, particularly budgetary and monetary policy.

The Federal Budget and Economic Stability

Federal expenditures and taxes affect total employment and production by influencing the total volume of spending for goods and services. Direct Federal purchases of goods and services are themselves part of total demand for national output. In addition, the Federal Government makes "transfer payments" to individuals, for which no current services are rendered in return. Examples are social security and unemployment insurance benefits, and veterans compensation and pension benefits. Both purchases of goods and services and transfer payments add to private incomes and thereby stimulate consumption and investment. Federal taxes, on the other hand, reduce disposable personal and business incomes, and restrain private spending.

By increasing the flow of spending, additional Federal outlays—with

tax rates unchanged—have expansionary effects on the economy. Whether an expansion in spending—government or private—leads mainly to more output or mainly to higher prices depends on the degree of slack in the economy. Under conditions of widespread unemployment and excess capacity, businessmen respond to higher demand by increasing production; under conditions of full employment, prices rise instead. In the slack economy of 1961, for example, additional demand from both private and public sources was readily converted into increased production.

Built into the Federal fiscal system are several automatic defenses against recession and inflation. Given the tax rates, tax revenues move up and down with economic activity, since most taxes are levied on private incomes or sales. Indeed, tax revenues change proportionally more than GNP. Furthermore, certain Federal expenditures, such as unemployment compensation payments, are automatically affected by the state of the economy. Economic fluctuations, therefore, result in substantial changes in Federal expenditures and revenues, even when basic expenditure programs and tax rates remain unchanged. With the present system of tax rates and unemployment compensation payments, a one-dollar reduction in GNP means a reduction in Federal tax receipts and an increase in transfer payments totaling about 30 cents. Therefore, private incomes after Federal taxes fall by only 70 cents for each reduction of one dollar in GNP. For this reason, any initial decline in spending and output is transmitted with diminished force to other sectors of the economy.

These automatic or built-in stabilizers moderate the severity of cyclical swings in the economy. If the forces causing a downturn in economic activity are weak and transient, the automatic stabilizers cushion the severity of the decline and give the basic recuperative powers in the private economy a better opportunity to produce a prompt and full recovery.

But if the forces causing the downturn are strong and persistent, the built-in stabilizers may not suffice to prevent a large and prolonged recession. Furthermore, they are blindly symmetrical in their effects. When economic activity quickens after a slump, the rise in Federal revenues begins immediately and slows the recovery in employment and incomes. For these reasons, the task of economic stabilization cannot be left entirely to built-in stabilizers. Discretionary budget policy, e.g., changes in tax rates or expenditure programs, is indispensable—sometimes to reinforce, sometimes to offset, the effects of the stabilizers.

To be effective, discretionary budget policy should be flexible. In order to promote economic stability, the Government should be able to change quickly tax rates or expenditure programs, and equally able to reverse its actions as circumstances change. Failure to arrest quickly a downturn in income, production, and employment may shake the faith of firms and households in prompt recovery and thereby lead to a cumulative decline. Delay in countering inflationary pressures may permit the

development of a self-propelling speculative boom, with disruptive consequences to the domestic economy and the balance of payments. If moderate fiscal action can be taken quickly and can be speedily reversed when circumstances warrant, the dangers of overstimulating or overrestricting the economy are much smaller than if fiscal responses are sluggish and difficult to reverse.

Fiscal policy can be made a more flexible and more powerful tool of economic stabilization by means that do not change the basic structure and level of taxation or the long-run size and composition of Federal expenditure programs. Changes in the basic structure and level of taxation should be made by the Congress with full deliberation in the light of the many relevant considerations, including the long-run revenue needs of the Government, equity among individuals and groups, and the effects of various taxes on economic efficiency and growth. Similarly, changes in the magnitude and content of government expenditures should represent the considered judgment of the people and the Congress on national priorities. For purposes of economic stabilization all that is needed of tax policy is temporary variation in the general level of tax rates within the existing structure, and all that is required of government outlays is timing of certain expenditures so that they bolster employment and purchasing power when the economy needs stimulus and taper off as it approaches full employment. In both cases, the form of action required for purposes of stabilization and the procedure for taking timely action can be agreed upon in advance.

Views of the Council of Economic Advisers, 1964

In its 1964 Report, the Council of Economic Advisers examined the role of the Federal government's policy in providing for the conditions conducive to full employment, describing the implications of the full employment budget (pp. 39–42).

FEDERAL POLICY AND FULL EMPLOYMENT

To comply with the mandate of the Employment Act of 1946 "to promote maximum employment, production, and purchasing power," the Federal Government must adjust its programs to complement private demand. Given the magnitude of its expenditure commitments, its revenue collections, its public debt management obligations, and its money and credit responsibilities, the Government inevitably exerts a powerful impact on demand. It is, therefore, a first principle of responsible Federal economic policy to try, insofar as possible, to adjust this impact in a way that promotes expansion and price stability.

The instruments of fiscal policy—Federal taxes, transfer payments, subsidies, grants-in-aid, and purchases of goods and services—are the Government's most powerful tools for promoting expansion. Federal

purchases of goods and services are themselves a component of demand, and indirectly they affect the other components. Through their impact on employment and income, they influence the level of consumption. By increasing sales and profits, they encourage investment expenditures. Similarly, taxes, transfers, and subsidies affect consumption and investment through their obvious effects on disposable incomes, after-tax profits, and incentives. Federal grants-in-aid finance many State and local expenditure programs.

These fiscal policy tools, while powerful, can at present be used by the Executive with only limited flexibility. Major expenditure programs must be related to a variety of domestic and international objectives as well as to the requirements of economic efficiency. They are therefore sometimes difficult to reconcile with income and employment goals in the annual budgetary process. Moreover, under our constitutional system, legislation needed to implement fiscal policies is the prerogative of the Congress. The Congress has demonstrated its ability to enact tax and expenditure legislation quickly in time of emergency, and the Executive Branch does have some flexibility in the timing of expenditures. This limited flexibility was used to good advantage in 1961. But without legislation to establish in advance specific rules designed to facilitate flexible fiscal policy—such as those requested by President Kennedy in 1962—tax and expenditure policies cannot be adjusted with sufficient speed to cope with the swift changes in private demand that bring recession or inflation. Greater flexibility would be desirable. However, the main function of fiscal policy must continue to be the provision of a good supporting framework for expansion.

THE FULL-EMPLOYMENT BUDGET

The Federal budget on a national income and product accounts basis gives the most comprehensive picture available of the revenue and expenditure activities of the Government as these affect private demands and the level of economic activity. This budget includes the receipts and expenditures of the Federal trust fund accounts, as well as those in the administrative budget, but excludes credit transactions. Unlike the administrative budget, it records corporate tax liabilities at the time they accrue rather than when collections are made. . . .

Federal policy decisions determine budgeted expenditures and a set of laws governing tax rates and transfer payments. The actual surplus or deficit position of the budget depends partly on the planned levels of expenditure and the rates incorporated in the tax structure, and partly on the general strength of private income and demand. Since both receipts and expenditures are affected by the level of private demand, the budget serves as an automatic stabilizer, moving into deficit in a recession and toward a surplus in recovery. . . .

The economic impact of a given budget program is best measured by its surplus or deficit at full-employment income levels. The surplus in the